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700472  
Sup. Ct.

# CLERK'S COPY.

## TRANSCRIPT OF RECORD

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

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No. 163

COMMISSIONER OF INTERNAL REVENUE,  
PETITIONER

VS.

LAIRD WILCOX AND MAUD WILCOX

---

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT  
OF APPEALS FOR THE NINTH CIRCUIT

---

PETITION FOR CERTIORARI FILED JUNE 25, 1945  
CERTIORARI GRANTED OCTOBER 8, 1945

No. 10895

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United States  
Circuit Court of Appeals

For the Ninth Circuit.

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LAIRD WILCOX and MAUD WILCOX, husband  
and wife,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the Tax Court  
of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES

EDWARD F. LUNSFORD, ESQ.,  
BERTRAM M. GOLDWATER, ESQ.,

For the Taxpayer.

T. M. MATHER, ESQ.,

For Commissioner.

## The Tax Court of the United States

Docket No. 3743

LAIRD WILCOX and MAUD WILCOX,

(husband and wife)

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

## PETITION

The above named petitioners hereby petition for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, San Francisco IRA:90-D RR, dated October 9, 1943, and as a basis of their proceedings allege as follows:

1. Petitioners are husband and wife, residing at 866 Forest Street, Reno, Nevada. The return for the period here involved was filed with the Collector for the District of Nevada.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to petitioners on October 9, 1943.

3. The taxes in controversy are income taxes for the calendar year 1941 and in the amount of \$2,978.09. (In [2\*] that amount there is included the tax on \$4.00 as an error in computation. This tax on the said \$4.00 petitioners herewith waive.)

4. The determination of tax set forth in said notice of deficiency is based upon the following

\*Page numbering appearing at top of page of original certified Transcript of Record.

error: The Commissioner has included as taxable gain or income the sum of \$12,748.60, which said sum is not gain or income within the meaning of Section 22 of the Internal Revenue Code of 1941.

5. The facts upon which petitioners rely as the basis of this proceeding are as follows:

(a) The said \$12,748.60 upon which the Commissioner bases the deficiency, represents funds which the husband, Laird Wilcox, during the taxable year feloniously and illegally withdrew from his employer, Nevada Transfer and Warehouse Company, a corporation, with its principal place of business at Reno, Nevada:

(b) The said sum was embezzled and taken from said employer and withheld by the said husband without any color of title or claim of right;

(c) That the said sum was taken and retained by said husband without any right or color of right;

(d) The said sum was lost by the petitioner husband in gambling and he realized no gain or profit from its use or conversion. [3]

Wherefore, petitioners pray that this Court may hear the proceeding and determine that petitioners are not liable for a deficiency for the year 1941.

LAIRD WILCOX

MAUD WILCOX

Petitioners.

866 Forest St., Reno, Nevada

4      *Laird Wilcox and Maud Wilcox*

State of Nevada,  
County of Washoe—ss.

Laird Wilcox, being duly sworn, says: That he is one of the petitioners above named; that he has read the foregoing petition, and is familiar with the statements contained therein, and that the statements contained therein are true.

LAIRD WILCOX

Subscribed and sworn to before me this 29th day of December, 1943.

[Seal]      MARIAN B. NOBLE

Notary Public in and for the County of Washoe,  
State of Nevada. [4]

State of Nevada,  
County of Washoe—ss.

Maud Wilcox, being duly sworn, says: That she is one of the petitioners above named; that she has read the foregoing petition and is familiar with the statements contained therein, and that the same are true except that she has been informed as to the facts set forth in Par. 5 of said petition, and as to those she believes the same to be true.

MAUD WILCOX

Subscribed and sworn to before me this 29th day of December, 1943.

[Seal]      MARIAN B. NOBLE

Notary Public in and for the County of Washoe,  
State of Nevada. [5]

EXHIBIT "A"

Form 1234

SN-IT-5

Treasury Department  
Internal Revenue Service  
74 New Montgomery Street  
San Francisco 5, California

Oct. 9 1943

Office of  
Internal Revenue  
Agent in Charge  
San Francisco Division

IRA 90-D

RR

Mr. Laird Wilcox and  
Mrs. Maud Wilcox,  
Husband and Wife,  
866 Forest Street,  
Reno, Nevada.

Sir and Madam:

You are advised that the determination of your income-tax liability for the taxable year (s) ended December 31, 1941 discloses a deficiency of \$2,978.09 as shown in the statement attached. Said deficiency has been assessed under the provisions of the internal-revenue laws applicable to jeopardy assessments.

In accordance with the provisions of existing internal-revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal

holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Respectfully,

GUY T. HELVERING,

Commissioner.

By F. M. HARLESS

Internal Revenue Agent in  
Charge.

Enclosure:

Statement [6]

# STATEMENT

San Francisco

IRA 90-D

RR

Mr. Laird Wilcox and  
Mrs. Maud Wilcox  
Husband and Wife,  
866 Forest Street,  
Reno, Nevada

Tax Liability for the Taxable Year Ended December 31, 1941.

Assessed—September 21, 1943 list

	Liability	Assessed	Deficiency
Income Tax .....	\$3,143.08	\$164.99	\$2,978.09

This determination of income tax liability is made on the basis of information on file in this office.

## ADJUSTMENTS TO NET INCOME

Net income as disclosed by return.....\$ 3,697.81

Unallowable deductions and additional income:

(a) Error in computation .....	\$ 4.00	
(b) Funds withdrawn .....	12,748.60	12,752.60

Net income adjusted .....\$16,450.41

# EXPLANATION OF ADJUSTMENTS

(a) An understatement of \$4.00 is noted in salaries reported. The correct difference between salary of \$3,800.00 and expenses of \$33.00 is \$3,767.00 instead of \$3,763.00.

(b) During the taxable year you withdrew funds of \$12,748.60 from the Nevada Transfer and Warehouse Company, which amount is included in your taxable income.

(c) Earned income credit of \$376.70 is allowed, representing 10 percent of your net salary of \$3,767.00 as corrected.

## COMPUTATION OF TAX

Net income adjusted .....\$16,450.41

Less:

Personal exemption .....\$1,500.00

Credit for dependents ..... 400.00 1,900.00

Balance (surtax net income) .....\$14,550.41

Less:

(e) Earned income credit

(10 per cent of \$3,767.00) ..... 376.70

Net income subject to normal tax.....\$14,173.71

Normal tax at 4 percent on .....\$14,173.71 \$ 566.95

Surtax on .....\$14,550.41 2,576.13

Correct income tax liability .....\$ 3,143.08

Income tax assessed:

Original, account No. 301109—District of Nevada... 164.99

Deficiency of income tax .....\$ 2,978.09

[Endorsed]: Filed T.C.U.S. Jan. 3, 1944. [8]

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioners, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that the determination of tax set forth in the notice of deficiency is based upon errors as alleged in paragraph 4 of the petition.

5. (a) Admits the allegations contained in subparagraph (a) of paragraph 5 of the petition. [9]

(b), (c), and (d) Denies the allegations contained in subparagraphs (b), (c), and (d) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

(Signed) J. P. WENCHEL TMM  
Chief Counsel,  
Bureau of Internal Revenue.

Of Counsel:

B. H. Neblett,  
Division Counsel.

T. M. Mather,  
Attorney,  
Bureau of Internal Revenue.

TMM/lrs 1/25/44

[Endorsed]: Filed T.C.U.S. Jan. 31, 1944. [10]

[Title of Tax Court and Cause.]

### STIPULATION OF FACTS

The undersigned counsel for the above respective parties hereby stipulate as follows:

That the said deficiency in the sum of \$2,978.09 results primarily from the inclusion in income of \$12,748.60 taken by the taxpayer from his employer, Nevada Transfer and Warehouse Company, a Nevada corporation, under the following circumstances:

(a) That the taxpayer, Laird Wilcox, entered the employ of Nevada Transfer and Warehouse Company in December of 1937, in the capacity of bookkeeper and continued in its employment until June of 1942;

(b) That during the last couple of years of his employment, he was receiving a salary of \$200.00 per month, payable semi-monthly; [11]

(c) That it was not the custom of his employer to allow him to draw in advance on his salary;

(d) That he drew and was paid his salary promptly as and when due;

(e) That in June of 1942 at the time his books were audited, his employer for the first time discovered that he had converted to his own use between June of 1941 and up to and including the 20th day of June, 1942, a total sum of \$22,896.01, of which the said sum of \$12,748.60, here in controversy, was taken by the taxpayer between and including June of 1941 and December 31, 1941;

(f) That at no time during said period was the employer indebted to him other than for his salary which was currently paid, as aforesaid;

(g) That the said \$12,748.60 was all composed of miscellaneous sums of money belonging to the employer and received and collected by the taxpayer at different times, in his capacity of bookkeeper; he failed to deposit said moneys to the credit of his employer; that the taxpayer made false and fictitious entries in the books of account of his employer in order to prevent discovery of the fact that moneys received by the taxpayer [12] for his employer were not credited and deposited to his employer's account; that the same were secretly and nefariously withheld by the taxpayer unknown to, and without the consent of, his employer; that the taxpayer in some instances pocketed and withheld

payments in cash made to him by customers of his employer and failed to credit the customers' accounts or his employer's accounts receivable with said sums;

(h) That the discovery of the foregoing acts of the taxpayer was not made until, as aforesaid, in June of 1942;

(i) That the taxpayer gambled and lost practically all of the money withheld by him, as aforesaid, from his employer, in different gambling houses in Reno, Nevada;

(j) That a criminal complaint charging the taxpayer with embezzlement covering the aforementioned acts, was filed in the Justice's Court of Reno Township, Washoe County, Nevada, on July 17, 1942, on which date he was arrested, thereafter arraigned and waived preliminary examination on July 20, 1942. An information was filed against him in the Second Judicial District Court of the State of Nevada, in and for the County of Washoe, on July 20, 1942, in the following language: [13]

"Douglas A. Busey, District Attorney within and for the County of Washoe, State of Nevada, in the name and by the authority of the State of Nevada, informs the above entitled Court that Laird Wilcox, Sr. the defendant above named, has committed a felony, to-wit: Embezzlement in the manner following:

That the said defendant on the 20th day of June, A. D. 1942, or thereabout, and before the filing of this information, at and within the

County of Washoe, State of Nevada, while an employee and agent of the Nevada Transfer and Warehouse Company, Incorporated, a Nevada corporation, was authorized to and did have possession of and charge of the collection and deposit of all moneys for the said Nevada Transfer & Warehouse Company; that said defendant, unlawfully, wilfully and feloniously, while so entrusted with the moneys so collected for the said Nevada Transfer & Warehouse Company, convert the sum of \$22,896.01, lawful money of the United States, to his own use, with the intent then and there to steal the same from and to defraud the said Nevada Transfer & Warehouse Company, a Nevada corporation, of Reno, Washoe County, Nevada. All of which is contrary to the form of the Statute in such case made and provided, and against the peace and dignity of the State of Nevada."

On the same day the information was filed, he was arraigned and entered a plea of guilty as charged. On July 21, 1942, he was sentenced to not less than two nor more than fourteen years imprisonment in the State Penitentiary at Carson City, Nevada. He served time in the Penitentiary on this sentence until paroled about the middle of December of 1943. Attached hereto and made a part hereof is a full, true and correct copy of the information to which he entered his plea of guilty as aforesaid. [14]

(k) That the taking of said sum as aforesaid has never been condoned nor forgiven by the em-

ployer, and it always has and now does hold the taxpayer liable to restore the same.

That in the trial of this case, the above entitled Court may treat and consider the above statement as constituting proven facts in this record.

Dated this 28th day of April, 1944.

E. L. LUNSFORD, and  
BERT GOLDWATER,

Attorneys for Petitioners

J. P. WENCHEL

Chief Counsel

TMM

Of Counsel

Attorneys for Respondent

[15]

In the Second Judicial District Court of the State  
of Nevada, in and for the County of Washoe

No. 71320

Dept. No. 1

THE STATE OF NEVADA, Plaintiff,

against

LAIRD WILCOX, SR.

Defendant.

### INFORMATION

Douglas A. Busey, District Attorney within and for the County of Washoe, State of Nevada, in the name and by the authority of the State of Nevada, informs the above-entitled Court that Laird Wil-

cox, Sr., the defendant above named, has committed a felony, to-wit: Embezzlement in the manner following:

That the said defendant on the 20th day of June A. D., 1942, or thereabout, and before the filing of this information, at and within the County of Washoe, State of Nevada, while an employee and agent of the Nevada Transfer and Warehouse Company, Incorporated, a Nevada corporation, was authorized to and did have possession of and charge of the collection and deposit of all moneys for the said Nevada Transfer & Warehouse Company; that said defendant, unlawfully, wilfully and feloniously, while so entrusted with the moneys so collected for the said Nevada Transfer & Warehouse Company, convert the sum of \$22,896.01, lawful money of the United States, to his own use, with the intent then and there to steal the same from and to defraud the said Nevada Transfer & Warehouse Company, a Nevada corporation, of Reno, Washoe County, Nevada.

All of which is contrary to the form of the Statute in such case made and provided, and against the peace and dignity of the State of Nevada.

DOUGLAS A. BUSEY

District Attorney of Washoe  
County, Nevada

By HAROLD O. TABER  
Deputy.

The following are the names of such witnesses as are known to me at the time of filing the within information:

Harry E. Stewart  
Ray Armstrong  
Sam Kafoury  
Mrs. Harry E. Stewart  
Paul Walker

DOUGLAS A. BUSEY

District Attorney of Washoe  
County, Nevada

By HAROLD O. TABER  
Deputy.

State of Nevada,  
County of Washoe—ss.

I, E. H. Beemer, County Clerk and ex-officio Clerk of the Second Judicial District Court of the State of Nevada, in and for Washoe County, said court being a court of record, having a common law jurisdiction, and a clerk and a seal, do hereby certify that the foregoing is a full, true and correct copy of the original, Information, In case No. 71320 Dept. No. 1. The State of Nevada, Plaintiff, against Laird Wilcox, Sr., Defendant, which now remains on file and of record in my office at Reno, in said County.

In Testimony Whereof, I have hereunto set my

hand and affixed the seal of said court, at Reno,  
this 15th day of March, A. D. 1944.

[Seal]              E. H. BEEMER

Clerk.

By M. COOPER

Deputy.

Filed: Jul 20, 10:15 A. M. '42. E. H. Beemer,  
Clerk; By A. G. Caughlin, Deputy.

[Endorsed]: Filed T.C.U.S. May 10, 1944 [16]

[Title of Tax Court and Cause.]

Edward F. Lunsford, Esq., and  
Bertram M. Goldwater, Esq.,

For the Petitioners.

T. M. Mather, Esq.,

For the Respondent.

#### MEMORANDUM OPINION

Opper, Judge: By this proceeding petitioners seek a redetermination of a deficiency in the sum of \$2,978.09 for the year 1941. The sole question for our determination is whether a sum embezzled by Laird Wilcox constitutes taxable income. A small adjustment in income from salary is conceded by petitioners.

All of the facts are stipulated and are hereby found accordingly.

Laird Wilcox, hereinafter referred to as petitioner, entered the employ of Nevada Transfer and

Warehouse Company in December of 1937 in the capacity of bookkeeper and continued in its employment until 1942. [17] During the last few years of his employment he was receiving a salary of \$200 per month, payable semi-monthly. It was not the custom of his employer to allow him to draw his salary in advance.

Petitioner drew and was paid his salary promptly as and when due. In June of 1942, at the time petitioner's books were audited, his employer for the first time discovered that petitioner had converted to his own use between June of 1941, and up to and including June 20, 1942, a total sum of \$22,896.01, of which sum \$12,748.60 was taken by petitioner between and including June of 1941, and December 31, 1941. This is the sum here in controversy.

At no time during this period was petitioner's employer indebted to him for other than salary which was currently paid. The \$12,748.60 was composed of miscellaneous sums of money belonging to petitioner's employer and received and collected by petitioner at different times in his capacity as bookkeeper. Petitioner failed to deposit the moneys to the credit of his employer and made false and fictitious entries in the accounts of his employer in order to prevent discovery. Petitioner, in some circumstances pocketed and withdrew payments in cash made to him by customers and failed to credit the customers' accounts or the employer's accounts receivable with the sums. The moneys were secretly

and nefariously withheld by petitioner without the knowledge or consent of his employer. Petitioner gambled and lost practically all the money withheld by him in various gambling houses in Reno, Nevada. [18]

A criminal complaint charging petitioner with embezzlement on the basis of the foregoing was filed on July 17, 1942, when petitioner was arrested. He was thereafter arraigned and waived preliminary examination on July 20, 1942. An information was filed against him in the Second Judicial District Court of Nevada on July 20, 1942, charging him with embezzlement. On the same day petitioner was arraigned and entered a plea of guilty as charged. He was sentenced to not less than two nor more than fourteen years imprisonment. He served this sentence until paroled about the middle of December of 1943.

The taking of the money as above set out has never been condoned or forgiven by the employer which always has and does now hold petitioner liable to restore it.

The present facts are indistinguishable from Estate of Thomas Spruance, 43 B.T.A. 221, and in our view the result that embezzled moneys constitute income taxable to the embezzler must equally apply here. True, that case was reversed on appeal by the Fifth Circuit, 127 Fed. (2d) 572, sub nom. McKnight, Administrator v. Commissioner. But in the meantime, two similar decisions of the Board of Tax Appeals had been affirmed. In Kurre v. Helvering, 126 Fed. (2d) 723, the Eighth Circuit af-

firmed a memorandum opinion<sup>2</sup> holding the proceeds of embezzlements taxable; and in *Humphreys v. Commissioner*, 125 Fed. (2d) 340, (certiorari denied 317 U. S. 637), the Seventh Circuit affirmed the Board's decision, 42 B.T.A. 857, in which it was held that ransom money obtained by a kidnapper, and to which his title was no better than to embezzled funds, "constitutes income under section 22 (a) of the Revenue Act of 1928." (page 880). [19]

In some respects the present proceeding may be slightly more favorable to respondent's position than *McKnight, Administrator v. Commissioner*, *supra*. There the Court pointed out that "the Board \* \* \* finds that the gain arose on his [the embezzler's] using the funds for his own purposes, whatever they were. The time of using, and not the time of taking, then would determine the incidence of the tax, and about that nothing is known;" [underscoring added] whereas, here it is stipulated that petitioner gambled and lost "practically all" the money withheld by him, and if the losses were not contemporaneous with the takings, petitioner certainly had the burden of proof.

Again, it is granted in the *McKnight* opinion that "It may be true that one who grows rich by systematic pilferings in his business which cannot be traced and recovered may realize taxable gain \* \* \*". Here, the size and circumstances of the thefts made discovery probable, and in fact it eventually occurred. But as of the end of the taxable year before us the embezzlements had not yet been unearthed, so that if the situation as it existed at the

end of the taxpayer's annual accounting period is controlling, the facts would not warrant the conclusion that he would certainly be called upon to make restitution. Cf. *North American Oil Consolidated v. Burnet*, 286 U. S. 417.

The difficulties of employing such a criterion as the test of taxability need not be explored at length, for it is only fair to concede that basically the McKnight case is inconsistent with the present result. Because the weight of authority is the other way, because our own decisions have consistently held such receipts to be taxable income, and because, [20] due to the conflict among the Circuits, and the lack of any controlling word from the Supreme Court, any conclusion we might reach would be irreconcilable with some authority, we feel compelled, with deference, to depart from the doctrine of that case. On the authority of *Estate of Thomas Spruance*, *Kurrie v. Helvering*, and *Humphreys v. Commissioner*, Decision will be entered for the respondent.

Enter:

Entered: Aug. 21, 1944. [21]

*vs. Commissioner of Internal Revenue*

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The Tax Court of the United States  
Washington

Docket No. 3743

LAIRD WILCOX and MAUD WILCOX,  
(husband and wife),

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the determination of the Court, as set forth in its Memorandum Opinion, entered August 21, 1944, it is Ordered and Decided: That there is a deficiency in income tax of \$2,978.09 for the year 1941.

Enter:

Entered Aug 22 1944

[Seal]

(Signed) WILLIAM W. ARNOLD,  
Judge. [22]

In the United States Circuit Court of Appeals  
for the Ninth Circuit

Dkt. No. 3743

LAIRD WILCOX and MAUD WILCOX,  
(husband and wife),

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

PETITION FOR REVIEW OF A DECISION  
OF THE TAX COURT OF THE UNITED  
STATES

To the Honorable Judges of the Circuit Court of  
Appeals for the Ninth Circuit:

Come Now, Laird Wilcox and Maud Wilcox,  
petitioners above named, and hereby petition for a  
review of a decision of the Tax Court of the United  
States, and respectfully show the Court:

(a) The nature of the controversy is that the  
Commissioner of Internal Revenue, respondent  
above named, determined a deficiency of \$2,978.09  
upon the income-tax return of petitioners for the  
calendar year 1941. The Commissioner of Internal  
Revenue determined said deficiency by including the  
sum of \$12,748.60 as taxable gain or income received  
by petitioners during said calendar year of 1941.  
Said sum of \$12,748.60 consists entirely of funds  
which the husband-petitioner, Laird Wilcox, during  
the taxable year 1941 feloniously and illegally em-

bezzled from his employer, Nevada Transfer and Warehouse Company, a corporation. Petitioners contend that said sum of \$12,748.60 does not constitute taxable gain or income and should not have been included in said income-tax return. The Tax Court of the United States [23] has held that said sum is taxable income and that said deficiency was properly determined by the Commissioner of Internal Revenue. A Memorandum Opinion for the respondent was entered August 21, 1944 in the Tax Court of the United States, and a Decision pursuant to said determination was entered by said Court August 22, 1944 that there is a deficiency in petitioners' income tax of \$2,978.09 for the year 1941. That said decision of the Tax Court of the United States is not in accordance with law and that said Court failed and refused to follow the case of *Mc Knight, Administrator vs. The Commissioner of Internal Revenue*, 127 Fed. (2d) 572, which decision by the Circuit Court of Appeals for the Fifth Circuit is the highest authority in point of law and the last case in point of time holding that embezzled monies do not constitute income taxable to the embezzler.

(b) Petitioners seek review in the Circuit Court of Appeals for the Ninth Circuit.

(c) The income-tax return for petitioners for the year 1941 was made and filed with the Collector of Internal Revenue for the District of Nevada, which district is within the Ninth Circuit, and within the jurisdiction of the Circuit Court of Appeals for the Ninth Circuit.

*Laird Wilcox and Maud Wilcox*

Wherefore, petitioners pray that this Honorable Court review the decision of the Tax Court of the United States.

EDWARD F. LUNSFORD  
BERT GOLDWATER

Attorneys for Petitioners, 206  
N. Virginia St., Reno, Nev.

[Endorsed]: T.C.U.S. Filed Sept. 12, 1944. [24]

The Tax Court of the United States

Docket No. 3743

LAIRD WILCOX and MAUD WILCOX (husband  
and wife),

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

NOTICE OF THE FILING OF A PETITION  
FOR REVIEW OF A DECISION OF THE  
TAX COURT OF THE UNITED STATES

To J. P. Wenchel, Chief Counsel of the Bureau of  
Internal Revenue, Washington, D. C.:

Notice is hereby given that Laird Wilcox and  
Maud Wilcox, husband and wife, petitioners above  
named, have filed with the Clerk of the Tax Court  
of the United States, a petition for review of the  
decision of the Tax Court of the United States in  
the above entitled action, which decision was en-

tered August 22, 1944, pursuant to a memorandum opinion in said Court entered August 21, 1944. Said petition seeks a review of said decision by the Circuit Court of Appeals for the Ninth Circuit.

Dated this 7th day of ~~8~~September, 1944.

Service of a copy of the foregoing, together with a copy of the petition for review, is hereby acknowledged this 13th day of September, 1944.

(s) J. P. WENCHEL,

Chief Counsel, Bureau of  
Internal Revenue.

EDWARD F. LUNSFORD  
BERTRAM M. GOLDWATER  
Attorneys for Petitioners  
206 N. Virginia Street  
Reno, Nevada

[Endorsed]: T.C.U.S. Filed Sept. 12, 1944. [25]

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[Title of Tax Court and Cause.]

### CERTIFICATE

I, B. D. Gamble, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 27, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States,

at Washington, in the District of Columbia, this  
26th day of Sept. 1944.

[Seal]

B. D. GAMBLE

Clerk, The Tax Court of the  
United States.

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[Endorsed]: No. 10895. United States Circuit  
Court of Appeals for the Ninth Circuit. Laird Wil-  
cox and Maud Wilcox, husband and wife, Petition-  
ers, vs. Commissioner of Internal Revenue. Re-  
spondent. Transcript of the Record. Upon Peti-  
tion to Review a Decision of The Tax Court of the  
United States.

Filed October 13, 1944.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

*vs. Commissioner of Internal Revenue.*

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In the United States Circuit Court of Appeals  
for the Ninth Circuit

No. 10895

LAIRD WILCOX and MAUD WILCOX, (hus-  
band and wife)

Petitioners.

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### SPECIFICATION OF ERROR

Come Now Laird Wilcox and Maud Wilcox, pe-  
titioners above named, and hereby specify the fol-  
lowing error and assign said error as the point upon  
which petitioners will rely in presenting this appeal,  
to-wit:

The holding of The Tax Court of the United  
States that embezzled funds are taxable as gross  
income was error.

Dated this 20th day of October, 1944.

EDWARD F. LUNSFORD  
BERT GOLDWATER

Attorneys for Petitioners  
206 North Virginia Street  
Reno, Nevada.

[Endorsed]: Filed Oct. 23, 1944. Paul P.  
O'Brien, Clerk.

In the United States Circuit Court of Appeals  
for the Ninth Circuit

No. 10895

**LAIRD WILCOX and MAUD WILCOX**, (hus-  
band and wife)

Petitioners,

v.

**COMMISSIONER OF INTERNAL REVENUE**,  
Respondent.

**DESIGNATION OF CONTENTS OF RECORD  
ON REVIEW**

To Paul P. O'Brien, Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue, Washington, D. C., and Samuel O. Clark, Jr., Assistant Attorney General of the United States, Washington, D. C.:

Please Take Notice that as required by Subdivision 6 of Rule 19 of the Rules of the United States Circuit Court of Appeals for the Ninth Circuit, petitioners in the above entitled cause do hereby designate the following portions of the records and proceedings to be contained in the transcript on review in the above entitled cause, to-wit:

1. The Petition in said action
2. The Answer in said action
3. The Stipulation of Facts in said action
4. The Memorandum Opinion in said action
5. The Decision in said action
6. The Petition for Review

7. The Notice of Filing Petition for Review
8. Specification of Error
9. This Designation of Contents of Transcript  
on Review.

Dated this 20th day of October, 1944.

**EDWARD F. LUNSFORD**  
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206 North Virginia Street  
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UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE NINTH CIRCUIT

Excerpt from Proceedings of Thursday, March 8, 1945

Before DENMAN, HEALY, and BONE, Circuit Judges

*Order of submission*

Ordered petition to review argued by Mr. Bert Goldwater, counsel for petitioners, and by Mrs. Muriel S. Paul, Special Assistant to the Attorney General, counsel for respondent, and submitted to the court for consideration and decision.

Excerpt from Proceedings of Friday, March 30, 1945

Before DENMAN, HEALY, and BONE, Circuit Judges

*Order directing filing of opinion and filing and recording of judgment*

By direction of the Court, ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this Court in accordance with the opinion rendered.

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 10,895—Mar. 30, 1945

LAIRD WILCOX AND MAUD WILCOX, HUSBAND AND WIFE,  
PETITIONERS

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon Petition to Review a Decision of the Tax Court of the United States

Before DENMAN, HEALY, and BONE, Circuit Judges.

DENMAN, Circuit Judge:

This is a review of decision of the Tax Court holding that an embezzler of moneys derives income from such moneys under Section 22 of the Internal Revenue Code, providing

"SEC. 22. GROSS INCOME.

"(a) General Definition—"Gross Income" includes gains, profits; and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever . . ."

and that such embezzled funds constitute a part of embezzler's taxable gross income.

Laird Wilcox, one of the petitioners, hereafter called Wilcox, entered the employ of the Nevada Transfer & Warehouse Co., a Nevada corporation, in December 1937, in the capacity of bookkeeper and continued in its employ until 1942. During his employment, Wilcox received a regular salary, payable semi-monthly, and was not allowed to draw his salary in advance and was paid his salary promptly as and when due. It is stipulated that at no time during that period of employment was the employer indebted to Wilcox other than for his salary which was currently paid.

In June 1942, when the books of the Nevada Transfer & Warehouse Co. were audited, it was discovered for the first time that Wilcox had converted to his own use between June 1941 and up to and including June 20, 1942, a total sum of \$22,896.01, of which sum \$12,748.60, now in controversy, was taken by him between and including June 1941 and December 31, 1941. The \$12,748.60 was composed entirely of miscellaneous sums of money belonging to the Nevada Transfer & Warehouse Co. and received and collected by Wilcox in his capacity of bookkeeper. He withheld the money which he had so embezzled from his employer and then used the money for gambling, losing practically all of it in different gambling houses in Reno, Nevada.

And information was filed against Wilcox for the crime of such embezzlement in the Second Judicial District Court of the State of Nevada, in and for the County of Washoe, on July 20, 1942. On the same day the information was filed he was arraigned and entered a plea of guilty as charged. On July 21, 1942, he was sentenced to not less than two nor more than fourteen years imprisonment in the State Penitentiary at Carson City, Nevada. He served time in the penitentiary on this sentence until paroled in December 1943.

The taking of the moneys by Wilcox from the Nevada Transfer & Warehouse Co. has never been condoned or forgiven by the employer and it always has and now does hold him liable to restore the same. Wilcox at no time claimed, nor could have claimed, that he took or held the moneys under any claim of right.

It is agreed that after the appropriation of the moneys there were no "dealings in the property" embezzled by which there were "gains" or "profits" within section 22, *supra*. The sole question is whether the embezzled moneys per se are to Wilcox "gains or profits" and income derived from any source whatever under that section.

The crime of embezzlement in Nevada is complete when the embezzler "use[s] or appropriate[s] such money \* \* \* in any manner or for any other purpose than that for which the same was \* \* \* entrusted." *State v. Trolson*, 21 Nev. 419, 425, 427. Here the record shows that the appropriation for gambling purposes occurred at the taking of the moneys.

Under the law of Nevada the employer here could have replevined the embezzled moneys in the possession of the embezzler as soon as he appropriated them. *Sec. 8681 Nevada Compiled Laws, 1929; Perkins v. Barnes*, 3 Nev. 510, 511; *Studebaker Co. v. Witcher*, 44 Nev. 468, 471. Also under the Nevada law an embezzler is liable to the party from whom the property is appropriated for an amount equal to its value. This is so whether after appropriation the moneys are hid in a basement or used in gambling. The use in no way transfers the property right of the owner in the moneys.

We agree with the Fifth Circuit decision in *McKnight v. Commissioner*, 127 F. 2d 572, that since the embezzler took the moneys with no conceivable claim or colorable claim of right, and held them not as his but as his employer's, it at no time became a taxable gain or profit or income to Wilcox, and adopt the reasoning of that opinion, based upon the statement in *North American Oil Consolidated Co. v. Burnet*, 286 U. S. 417, 424: "If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

Respondent claims that the decision in the Eighth Circuit in *Kurrie v. Helvering*, 126 F. 2d 723, is *contra*. That decision, however, relies upon the statement of law in the *North American*

<sup>1</sup> Cf. *Boston Consolidated Gas Co. v. Commissioner*, 128 F. 473, 477, opinion *Magruder, C. J.*; *Caldwell v. Commissioner*, 135 F. 2d 488, 491.

Consolidated Oil case, *supra*, concerning a taxpayer who "receives earnings under a claim of right" and appears to hold that, though received without claim of right, they are taxable if the embezzler subsequently "treated said funds as if his own" in a profitable enterprise. If this be not a ground of distinguishing the Kurre case from the instant review, we are not in accord with that opinion.

The Commissioner relies upon *Helvering v. Clifford*, 309 U. S. 331. That case construed a complicated trust instrument to determine to whom the income of the trust is taxable. In the present case there was no income to the embezzler from the embezzled funds and no analogous trust relationship. What was said in the Clifford case at page 334 concerning "Technical considerations, niceties of the law of trusts or conveyances, or the legal paraphernalia which inventive genius may construct as a refuge from surtaxes should not obscure the basic issue. That issue is whether the grantor after the trust has been established may still be treated, under this statutory scheme, as the owner of the corpus," has no application to the title to embezzled moneys which the owner could replevin as soon as appropriated by the embezzler.

In all of the other cases cited by the Commissioner<sup>2</sup> the moneys, though fraudulently or illegally acquired, came to the taxed party from their owner by the latter's conscious act, in response to a claim for an agreed service by the party to whom they were paid. All are cases where the recipients are taxable within the rule in the North American Consolidated Oil case, *supra*. They have no bearing on the taxability of an embezzler in whose hands the embezzled money always belonged to the wronged owner.

The order of the Tax Court is

Reversed.

(Endorsed:) Opinion. Filed March 30, 1945. Paul P. O'Brien, Clerk.

(T. C. Memo. Opinion 8-21-44)

### *Judgment*

Upon Petition to Review a Decision of the Tax Court of the United States.

This Cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted.

<sup>2</sup> Such as *Caldwell v. Commissioner*, 125 F. 2d 488, (C. C. A. 5); *Chadick v. United States*, 77 F. 2d 961 (C. C. A. 5); *Humphrey v. Commissioner*, 125 F. 2d 340 (C. C. A. 7).

On consideration whereof, it is now here ordered and adjudged by this Court, that the decision of the said Tax Court of the United States in this Cause be, and hereby is, reversed.

(Endorsed:) Judgment. Filed and entered March 30, 1945.  
Paul P. O'Brien, Clerk.

*Certificate of clerk U. S. Circuit Court of Appeals for the Ninth Circuit, to record certified under rule 38 of the revised rules of the Supreme Court of the United States*

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing thirty-six (36) pages, numbered from and including 1 to and including 36, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the respondent, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 31st day of May 1945.

[SEAL]

PAUL P. O'BRIEN, Clerk.

## Supreme Court of the United States

*Order allowing certiorari*

Filed October 8, 1945

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice JACKSON and Mr. Justice BURTON took no part in the consideration or decision of this application.

FILE COPY

JUN 25 1945

CHARLES F. WILSON, JR.

No. 163

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**In the Supreme Court of the United States**

OCTOBER TERM, 1945

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

*v.*

LAIRD WILCOX AND MAUD WILCOX

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE NINTH  
CIRCUIT

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(1)

# **In the Supreme Court of the United States**

OCTOBER TERM, 1945

No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LAIRD WILCOX AND MAUD WILCOX

## **PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT**

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, reversing the decision of the Tax Court in this case.

### **OPINIONS BELOW**

The opinion of the Tax Court (R. 16-20) is unreported. The opinion of the circuit court of appeals (R. 30-33) is not yet reported.

### **JURISDICTION**

The judgment of the circuit court of appeals was entered on March 30, 1945 (R. 33-34). The jurisdiction of this Court is invoked under Sec-

tion 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

#### QUESTION PRESENTED

Does embezzled money constitute taxable income to the embezzler under the broad provision of Section 22 (a) of the Internal Revenue Code?

#### STATUTE AND REGULATIONS INVOLVED

##### Internal Revenue Code:

##### SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*

(26 U. S. C., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent,

dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. \* \* \*

#### STATEMENT

The facts as stipulated (R. 9-13) and as so found by the Tax Court (R. 16) are the following:

The taxpayer, Laird Wilcox, was employed as a bookkeeper of the Nevada Transfer and Warehouse Company from 1937 to 1942 (R. 16-17). During the year 1941 he converted to his own use \$12,748.60 of his employer's funds, composed of miscellaneous sums of money received and collected by him at different times in his capacity as bookkeeper (R. 17). He lost practically all of the money taken in gambling houses in Reno, Nevada (R. 18). The company always paid the taxpayer's salary promptly, never permitted him to make advance withdrawals, and was never indebted to him except for salary (R. 17). It did not consent to the secret appropriations and did not discover them until June, 1942, when an audit was made of the taxpayer's books (R. 17). It never forgave or condoned the taking of the money and still holds the taxpayer liable to restore it (R. 18). On July 20, 1942, the taxpayer was arraigned in a state court in Nevada for the

crime of embezzling a total of \$22,896.01, entered a plea of guilty as charged, and was sentenced to not less than two or more than fourteen years of imprisonment (R. 17, 18). He was paroled in the middle of December, 1943 (R. 18). The Commissioner determined that the taxpayer was required to report the \$12,748.60 embezzled as income for the year 1941 (R. 9). The Tax Court sustained the Commissioner (R. 20). The court below reversed the decision of the Tax Court (R. 33).

#### SPECIFICATION OF ERROR TO BE URGED

The circuit court of appeals erred in holding that the embezzled moneys did not constitute taxable gains or profits or income within the meaning of Section 22 (a) of the Internal Revenue Code.

#### REASONS FOR GRANTING THE WRIT

The decision of the court below is in direct conflict with that of the Circuit Court of Appeals for the Eighth Circuit in *Kurrie v. Helvering*, 126 F. 2d 722, although in accord with *McKnight v. Commissioner*, 127 F. 2d 572 (C. C. A. 5). The difference between the courts stems from varying interpretations of the scope of *North American Oil v. Burnet*, 286 U. S. 417. In that case a receiver held property pending litigation between the United States and the North American company as to its beneficial ownership. Income earned by the property in 1916 was turned over by the receiver to the company in 1917 upon entry

of a final decree in the district court dismissing the bill of the United States. The appellate phases of the litigation were finally terminated in 1922. The question was whether the income should have been reported by the company in 1916, 1917 or 1922. This Court held that the company was not required to report in 1916 an amount which it might never receive. In holding the income taxable in the year 1917 rather than in 1922, the Court said (p. 424):

If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.

This language was relied upon by the court below in the instant case (R. 32) as establishing that money taken from an employer without claim of right—as in an outright embezzlement—does not constitute income to the taker. In so applying the language to the facts of this case, we believe that the court committed plain error. In the *North American Oil* case this Court was not concerned with the taxability of funds received without claim of right, and there is no reason to suppose that the language used was intended to mark the outermost limits of the concept of income. Cf. *Helvering v. Clifford*, 309 U. S. 331, 334.

The Tax Court has consistently (R. 20) held such receipts to be taxable income. See, also, G. C. M. 16572, XV-1 Cum. Bull. 82 (1936), ruling that the proceeds of an embezzlement constitute taxable income.

#### CONCLUSION

While the taxability of embezzled funds is not in its nature one of the major problems of tax administration, the question presented is one of general application on which the circuits are in conflict, and the decision below is contrary to the settled administrative construction and to the settled view of the Tax Court. Since administrative confusion will be unavoidable until the conflict is resolved, it is respectfully submitted that this petition should be granted.

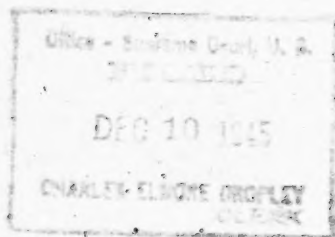
CHARLES FAHY,  
*Solicitor General.*

**JUNE 1945.**

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<sup>1</sup> See, also, G. C. M. 16730, XV-1 Cum. Bull. 179, likewise issued in 1936, and adhering to the doctrine of "claim of right" in regard to legally disputed funds.

FILE COPY



No. 163

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**In the Supreme Court of the United States**

OCTOBER TERM, 1945

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LAIRD WILCOX AND MAUD WILCOX

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT  
COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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# ***In the Supreme Court of the United States***

OCTOBER TERM, 1945

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No. 163

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LAIRD WILCOX AND MAUD WILCOX

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT  
COURT OF APPEALS FOR THE NINTH CIRCUIT

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## **BRIEF FOR THE PETITIONER**

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### **OPINIONS BELOW**

The opinion of the Tax Court of the United States (R. 16-20) is unreported. The opinion of the Circuit Court of Appeals (R. 30-33) is reported at 148 F. 2d 933.

### **JURISDICTION**

The judgment of the Circuit Court of Appeals was entered on March 30, 1945. (R. 33-34.) The petition for certiorari was filed on June 25, 1945 and was granted on October 8, 1945 (R. 35). Jurisdiction is conferred on this Court by Section 240 (a) of the Judicial Code, as amended.

## QUESTION PRESENTED

Whether embezzled money constitutes taxable income to the embezzler under Section 22 (a) of the Internal Revenue Code.

## STATUTE AND REGULATIONS INVOLVED

## Internal Revenue Code:

## SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*

\* \* \* \* \*

(26 U. S. C. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless

exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. \* \* \*

#### STATEMENT

The facts as stipulated (R. 9-13) and as found by the Tax Court (R. 16) are the following:

Laird Wilcox, the taxpayer, was employed as a bookkeeper by the Nevada Transfer and Warehouse Company from 1937 to 1942. During the last few years of his employment he was receiving a salary of \$200 per month which he was paid promptly when due. It was not the custom of his employer to allow him to draw his salary in advance. (R. 16-17.)

In June of 1942, at the time the company's books were audited, his employer for the first time discovered that the taxpayer had converted to his own use \$12,748.60 during the year 1941. This amount was composed of miscellaneous sums of money received and collected by taxpayer at different times in his capacity as bookkeeper. Taxpayer failed to deposit the moneys to the credit of his employer but pocketed and withdrew payments in cash made to him by customers and failed to credit the customers' accounts or the employer's accounts receivable with the sums received. (R. 17.)

The taxpayer lost practically all the money in various gambling houses in Reno, Nevada. Taxpayer's employer never condoned or forgave the taking of the money and still holds the taxpayer liable to restore it. (R. 18.)

On July 17, 1942, the taxpayer was arrested and on July 20, 1942, was arraigned in a Nevada state court for the crime of embezzlement of \$22,896.01.<sup>1</sup> He entered a plea of guilty as charged and was sentenced to not less than two nor more than fourteen years of imprisonment. He served this sentence until paroled in the middle of December, 1943. (R. 18.)

The Commissioner determined that the taxpayer was required to report the \$12,748.60 embezzled in 1941 as income in that year and asserted a tax deficiency of \$2,978.09.<sup>2</sup> (R. 9.) The Tax Court sustained the Commissioner. (R. 20.) The court below reversed the decision of the Tax Court. (R. 33.)

#### **SPECIFICATION OF ERROR TO BE URGED**

The Circuit Court of Appeals erred in holding that the embezzled moneys did not constitute taxable gains or profit or income within the meaning of Section 22 (a) of the Internal Revenue Code and in reversing the order of the Tax Court.

<sup>1</sup> The sum of \$10,147.41 was embezzled in the taxable year 1942. (R. 17.)

<sup>2</sup> This deficiency also reflected an error of \$4 in reported gross income which is not here relevant.

### ARGUMENT

**Embezzled money constitutes taxable income to the embezzler under the broad provisions of Section 22 (a) of the Internal Revenue Code**

Section 22 (a) of the Internal Revenue Code, *supra*, defining income for tax purposes, is couched in broad language. *Helvering v. Clifford*, 309 U. S. 331, 334. Nevertheless the court below overruled the Tax Court which held, as it had in several previous cases, that embezzled funds constitute income.<sup>3</sup> See *Spruance v. Commissioner*, 43 B. T. A. 221, reversed *sub nom. McKnight v. Commissioner*, 127 F. 2d 572 (C. C. A. 5th); *Kurrle v. Commissioner*, decided January 30, 1941 (1941 B. T. A. Memorandum Decisions, par. 41,085), affirmed 126 F. 2d 723 (C. C. A. 8th). The administrative interpretation is to the same effect as the Tax Court's decisions.<sup>4</sup> We submit that the decision below was wrong.

Tax liability, it is clear, "may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it

<sup>3</sup> The Income Tax Act of 1913, c. 16, 38 Stat. 114, 167, Section II B, defined income as including "gains, profits, and income derived from \* \* \* the transaction of any *lawful* business carried on for gain or profit. \* \* \*." [Italics supplied.] In the Revenue Act of 1916, c. 463, 39 Stat. 756, Section 2 (a), the term "lawful" was deleted.

<sup>4</sup> G. C. M. 16572, XV-1 Cum. Bull. 82 (1936). It was pointed out that the proceeds of an embezzlement are a gain and that the expenditure of human energy in acquiring them is the labor involved within the meaning of Regulations 103, *supra*.

reasonable and just to deal with him as if he were the owner, and to tax him on that basis". *Burnet v. Wells*, 289 U. S. 670, 678. Hence the Government may tax not only ownership, but also "any right or privilege that is a constituent of ownership." *Ibid.* Section 22 (a) has been held by this Court in other situations to embody an exercise of the power to tax as income the acquisition of benefits other than ownership. *Helvering v. Clifford*, *supra*; *Helvering v. Horst*, 311 U. S. 112. Equally, we submit, should the acquisition of benefits by the embezzler of property or funds be regarded as the receipt of income by him.

The act of appropriating property to one's own use is an exercise of a major power of ownership even though the act is consciously and entirely wrongful. Indeed, as against all the world except the true owner the embezzler or thief is the legal owner, at least while he remains in possession. Pollock & Wright; *Essay on Possession* (1888) pp. 91, 151-152; 7 Holdsworth, *History of English Law*, p. 429; *Anderson v. Gouldberg*, 51 Minn. 294 (1892). In a case like the present the command of the wrongdoer over the funds taken is emphasized by the use made of them; for he gambled them away, dissipating them permanently in the purchase of personal satisfactions.

In *Kurrle v. Commissioner*, *supra*, the Circuit Court of Appeals for the Eighth Circuit gave effect to the view here urged by holding embezzled

funds to be taxable income. The court below (R. 33) attempted to distinguish that case upon the ground that the embezzler there "treated said funds as if his own" in a profitable enterprise." This attempted distinction breaks down, however; for in the *Kurrle* case the embezzler was a conscious wrongdoer who used the ill-gotten gains in market operations. In both cases there was a finding by the trial court that the embezzler treated the funds as his own. The fact that in the *Kurrle* case the use of the funds resulted in a profit,<sup>5</sup> while in the present case they were lost, does not change the character of the dominion under which they were used. There is nothing in the opinion in the *Kurrle* case which has reference to any such distinction or lessens the authority of the decision as a holding that the dominion assumed by an embezzler for his own benefit produces income to him.

In *National City Bank of New York v. Helvering*, 98 F. 2d 93, the Circuit Court of Appeals for the Second Circuit adopted the principle that embezzled funds constitute taxable income to the embezzler, although the court had previously stated the contrary in *Rau v. United States*, 260 Fed. 131, 136. In the opinion in the *National City Bank* case it was recognized (p. 96) that "the weight of authority is against" the view earlier expressed, which, moreover, the court character-

<sup>5</sup> The profits were, of course, also held to be taxable income.

ized as "wrong in principle." The *National City Bank* case involved certain bonds which one O'Neil had retained as his own although they belonged to the corporation of which he was president. The Circuit Court of Appeals remarked (p. 95) that although the bonds were the property of the corporation in the sense that it could have reclaimed them, "if he [O'Neil] holds with claim of right, he should be taxable as an owner, regardless of any infirmity of his title." [P. 96, italics supplied.] It is evident that that court did not use the term "claim of right" in the sense of strictly lawful claim, nor did it interpret this Court's statement in *North American Oil v. Burnet*, 286 U. S. 417, 424 (*infra*, p. 11), in the narrow sense urged by the taxpayer here. Consciousness of guilt does not negative the fact of beneficial dominion over property, to which Section 22 (a) attaches tax liability.

In other situations the taint of illegality does not remove a taxpayer's receipts from the income upon which a tax must be paid, *Johnson v. United States*, 318 U. S. 189 (income arising from illegal gambling); *United States v. Sullivan*, 274 U. S. 259 (income arising from prohibited transactions with respect to the sale of liquor); *Caldwell v. Commissioner*, 135 F. 2d 488 (C. C. A. 5th) (money received by a state official as bribes from contractors for the securing of state contracts and other favors); and this is true even though the recipient is under an obligation to make restitu-

tion to the persons wrongfully deprived, *Chadick v. United States*, 77 F. 2d 961 (C. C. A. 5th), certiorari denied, 296 U. S. 609, and *Barker v. Magruder*, 95 F. 2d 122 (App. D. C.) (usurious interest); *Chicago, R. I. & P. Ry. Co. v. Commissioner*, 47 F. 2d 990 (C. C. A. 7) (railroad overcharges). Certainly tax liability does not turn upon distinctions which operate in inverse ratio to the degree of the taxpayer's criminality. Thus, funds received as ransom money have been held to constitute taxable income. *Humphreys v. Commissioner*, 125 F. 2d 340 (C. C. A. 7th), certiorari denied, 317 U. S. 637. It sets up a fanciful distinction to assert, as did the court below (R. 33), that in such a case the kidnaper has a claim of right because the money came to him from the owner "by the latter's conscious act, in response to a claim for an agreed service."

The fact that an embezzler may, in the future, be required to make restitution of the funds which he has appropriated and used as his own does not establish his immunity from taxation upon them. His legal liability, which is unquestioned, does not negative the crime involved in the appropriation or the benefits which accrue to the taker by reason of it. Even an actual intent by the taker at the time of the taking to restore the embezzled funds leaves him guilty of the offense, because an intent to use another's property without permission in such a manner as to incur great risk of loss is a sufficient criminal intent. *People v. Nevin*, 343

Ill. 597 (1931); *Commonwealth v. O'Connell*, 274 Mass. 315, 321-322 (1931); *State v. Trolson*, 21 Nev. 419 (1893); *State v. Liliopoulos*, 167 Wash. 686, 690 (1932). See Clark & Marshall on *Crimes* (4th ed., 1940), pp. 426, 428-429; Miller, *Handbook of Criminal Law* (1934), 365-367. The intent to make restitution neither negatives criminality nor changes the actual character of the gain which the wrongdoer accomplishes for himself.

It is significant that under the income tax laws a debt and the liability created by a theft are differently treated. As to the former, default by the debtor may give rise to a deductible loss only when the debt becomes worthless, whereas a theft creates a deductible loss from the beginning. Internal Revenue Code, §§ 23 (e), 23 (k) (1), 26 U. S. C. 23 (e), 23 (k) (1); *First National Bank v. Heiner*, 66 F. 2d 925 (C. C. A. 3); compare *John H. Farish & Co. v. Commissioner*, 31 F. 2d 79 (C. C. A. 8), where the money taken was not the taxpayer's but trust funds owing to clients; and see *Burnet v. Huff*, 288 U. S. 156. This distinction between bad debts and losses by theft is realistic and should carry over into the determination of an obligor's tax liability upon the sums which he has received. The income to the embezzler accrues at the time of the theft, not at some theoretical later time when the remote possibility of restitution is somehow extinguished.

The court below (R. 32) based its decision partly upon a theory derived from a statement of

this Court in *North American Oil v. Burnet*, 286 U. S. 417, 424, that—

If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.<sup>6</sup>

Nothing in that case warrants the adoption of such a theory, however, for in the *North American Oil* case there were no illegal gains involved. The income in question consisted of income from property which a receiver held impounded pending litigation between the United States and the North American Oil Company as to its beneficial ownership.<sup>7</sup> Income earned in 1916 was turned over to the company in 1917 upon entry of a final decree in the district court dismissing the bill of the United States. The appellate phases of the litigation were finally terminated favorably to the taxpayer in 1922. The question was whether the income should have been reported by the company in 1916, 1917, or 1922. This Court held (p. 424) that the profits became income of the company in 1917, "when it first became entitled to them and when it actually received them."

<sup>6</sup> See also G. C. M. 16730, XV-1 Cum. Bull. 179 (1936).

<sup>7</sup> As stated (p. 422), it was "conceded that the net profits earned by the property during the receivership constituted income."

Ill. 597 (1931); *Commonwealth v. O'Connell*, 274 Mass. 315, 321-322 (1931); *State v. Trolson*, 21 Nev. 419 (1893); *State v. Liliopoulos*, 167 Wash. 686, 690 (1932). See Clark & Marshall on *Crimes* (4th ed., 1940), pp. 426, 428-429; Miller, *Handbook of Criminal Law* (1934), 365-367. The intent to make restitution neither negatives criminality nor changes the actual character of the gain which the wrongdoer accomplishes for himself.

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<sup>6</sup> See also G. C. M. 16730, XV-1 Cum. Bull. 179 (1936).

<sup>7</sup> As stated (p. 422), it was "conceded that the net profits earned by the property during the receivership constituted income."

Hence it appears that the statement in the opinion, quoted above, had reference to a situation in which the taxpayer took under a claim of right, and it cannot be understood to negative the possibility of taxable income without such a claim or to have been intended to mark the outermost limits of the concept of income. The attempt so to apply it here is, we submit, inadmissible.

#### CONCLUSION

We think it is clear that under the broad concept of income embezzled funds constitute income to the embezzler. He is the recipient of virtually all benefits of ownership during the taxable year in which he obtains the money. The absence of a claim of right or the existence of a duty to make restitution, like illegality in the acquisition of money or property in certain other situations, should not control the statutory meaning of income.

For these reasons, the judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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RALPH F. FUCHS.

DECEMBER 1945.

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**No. 163**

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**In the Supreme Court of the United States**

**OCTOBER TERM, 1945**

**COMMISSIONER OF INTERNAL REVENUE, PETITIONER**

**v.**

**LAIRD WILCOX AND MAUD WILCOX**

---

**Brief of Respondents in Opposition to Petition for a  
Writ of Certiorari to the Circuit Court of Appeals  
for the Ninth Circuit**

---

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I.

**There Is No Conflict Between the Circuits on the  
Question of Whether Embezzled Money Constitutes  
Taxable Income to the Embezzler.**

The decision of the Ninth Circuit Court below, in the case at bar, *Wilcox v. Commissioner*, 148 Fed. (2d) 933, is not in conflict with *Kurrle v. Helvering*, 126 Fed. (2d) 723, (CCA 8th). The case of *Wilcox v. Commissioner*, *supra*, follows *McKnight v. Commissioner*, 127 Fed. (2d) 573, (CCA 5th).

In both the case at bar, *Wilcox v. Commissioner*, *supra*, and *McKnight v. Commissioner*, *supra*, the Circuit Courts found that the embezzler took the monies with no conceivable claim or colorable claim of right, and held them not as his own but as those of a third person, the monies at no time becoming a taxable gain or profit or income.

These holdings can not be in conflict with *Kurrle v. Commissioner*, *supra*, where the Court found, at page 724

of 126 Fed. (2d), that the embezzler had "treated said funds as his own" in a profitable enterprise. There is, in the latter case, a difference between the case at bar and the case of *McKnight v. Commissioner* by reason of the claim of right to the monies which the embezzler in the *Kurrie* case was found to have by the Court.

## II.

### **The Rule Laid Down by the Supreme Court in *North American Oil v. Burnet*, 286 U.S. 417, Has Been Properly Applied in Determining What Is Income.**

Although the case of *North American Oil v. Burnet*, 286 U.S. 417, did not involve embezzlement, the principle of that case laid down at page 424 of 286 U.S. has been rightfully used to determine what is income. The Court there said:

"If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

That language has been relied upon by numerous Circuit Courts in determining whether money received constitutes income. The rule was applied in *Commissioner v. Turney*, 82 Fed. (2d) 661; *National City Bank v. Helvering*, 98 Fed. (2d) 93, at pages 95, 96; *Moore v. Thomas*, 131 Fed. (2d) 611, at page 615, and *Caldwell v. Commissioner*, 135 Fed. (2d) 488, at page 491. In the *North American Oil* case, the Court held that funds received or appropriated with a claim of right were taxable. The Circuit Courts have so applied the rule, asking in each

case whether the funds were received or appropriated with a claim of right, in order to arrive at the solution of whether the funds were income to the receiver or appropriator. Failing to find a claim of right, the Courts have consistently held, in accordance with the rule of the *North American Oil* case, that there was no income.

### III.

**Since the Embezzlement of the Property or Assets of Another Immediately Gives Rise to an Unqualified Liability and Duty to Restore to the Owner Thereof the Funds or Assets So Embezzled, or to Compensate Him Therefor, the Possession of Funds or Assets Acquired in Such Manner Does Not, Under the Constitution and Laws of the United States, Give Rise to Gains, Profits or Income Subject to Federal Income Tax.**

Unlike illegal profits or gain from a business condemned by the penal laws, and, further, unlike profits or gain from business transactions held under a claim of right not theretofore adversely adjudicated and under circumstances that refund may yet be demanded, embezzled funds constitute no gain or profit.

Embezzled funds may be distinguished from other moneys in the following manner:

1. The embezzler gets no title to what he took.
2. The embezzler has no right or color of right to the funds.
3. The embezzler claims no right or color of right to the funds.
4. The embezzler incurs an equivalent debt at the time of taking.
5. There is no consideration of labor, services, merchandise or risk of capital by the embezzler.

We rely on *McKnight v. Commissioner of Internal Revenue*, 127 Fed. (2d) 572, and upon the better reasoning which is set out in that case. That case holds embezzled funds to be not taxable, inasmuch as they do not constitute gain or profit.

The Court in the *McKnight* case treats the embezzler as a debtor, and states (at page 573 of 127 Fed. (2d)):

"We find insuperable difficulties in the way of conclusion that one who embezzles funds entrusted to him realizes gain and receives taxable income thereby. Gain is very broadly defined, as to its sources, in the Revenue Acts, Revenue Act 1934, Sect. 22; Revenue Act 1936, Sect. 22(a), 26 U. S. C. A. Int. Rev. Code, par. 22. The classic definition of income is: 'Gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets." *Eisner v. Macomber*, 252 U. S. 189, 40 S. Ct. 189, 193, 64 L. Ed. 521, 9 A. L. R. 1570. It does not appear here what the embezzler did with what he took, whether he realized any profit from its use or conversion, or even got any enjoyment by spending it. All we know is it is gone and he is left insolvent. Was gain realized by the act of taking? We think not. He got no title, void or voidable, to what he took. He was still in possession as he was before, but with a changed purpose. *He still had no right nor color of right. He claimed none. This the Board seems to concede*, and finds that the gain arose on his using the funds for his own purposes, whatever they were. The time of using, and not the time of taking, then would determine the incidence of the tax, and about that nothing is known. But when the entrusted fund is used, or even when taken with the purpose of dishonest use, *the law immediately and absolutely fires upon the embezzler the duty to account for and to repay the value of what is taken. By the taking the*

*embezzler incurs an equivalent debt as surely as if he had borrowed with the consent of the owner. The first takings are, indeed, nearly always with the intention of repaying, a sort of unauthorized borrowing. It must be conceded that no gain is realized by borrowing, because of the offsetting obligation. This would be true even though at the time there was no intention to repay. It seems to us that the same thing is true of each act of embezzlement. Commissioner v. Turney, 5 Cir., 82 F. 2d 661.* (Italics supplied.)

There being an equivalent "offsetting obligation" as stated by the Court, there can be no taxable gain. Moneys received by way of loan do not constitute taxable income.

*William G. Stoughton, Jr.*, 32 B. T. A. 940;

*Carl G. Fishyr*, 7 B. T. A. 968.

It has heretofore been argued in other cases that borrowed money is not converted into income if the borrower spends the money for his own pleasure. So, too, embezzled money is not income by being spent, there existing in both cases an unqualified duty and obligation to repay the same.

And under the principle involved, there can be no difference whether the money was legally borrowed or illegally taken. In both cases, the duty to repay immediately impresses itself upon the funds, offsetting any concept of gain or profit.

We have stipulated with counsel for the Commissioner that the money embezzled is still due the rightful owner and that it always has and now does hold the taxpayer liable to restore the same. (See part (k) of Stipulation of Facts (R. 12-13). Thus, there is in the instant case an

established creditor-debtor relation between the embezzler and the rightful owners.

We have listed five ways which distinguish embezzled funds from other moneys. We think there can be no dispute with the first, that the embezzler gets no title to what he took; nor with the second, that the embezzler has no right or color of right to the funds; nor the third, that the embezzler claims no right or color of right to the funds; nor, as we have illustrated, that the embezzler incurs an equivalent debt at the time of taking. As to the fifth distinguishing feature that the embezzler risks no capital and gives no labor or services, we think clearly makes embezzlement cases unique from all others. In the cases of illegal profits from businesses in violation of the law, there is clearly consideration for labor or capital and a gain on the labor or capital risked. In all other cases there is some transaction or deal between the taxpayer and the one from whom he obtains the money. There is some labor or service performed or some capital risked.

As an instance, let us take the case of *Humphrey v. Commissioner*, 125 Fed. (2d) 340, where \$50,000 in ransom was held to be income. There, the illegal holding of a human being caused a business transaction, however illegal in itself, to arise. There was consideration, no matter how wrongful, for the payment of the money. There was a *claim of right* to the money as consideration for delivery of the body of the kidnapped victim.

Again, in *United States v. Wampler*, 5 Fed. Supp. 796, an attorney was held taxable on income constituting money which was given to him to settle a case and part

of which he retained after settling the matters for less than the amount delivered to him. The Court held that the act was not embezzlement. (See p. 798 of 5 Fed. Supp.) The attorney had clearly given some services as part of the consideration. The money was delivered to him in a business transaction in which he was to give some services.

#### IV.

### **Money Taken Through Embezzlement Is Not Taxable Gain and Is Distinguished From All Other Illegal Acquisition Which Arises From Unlawful Business Transactions.**

We concede that illegal profits and illegal gains are income. It is well settled that actual gains or profits may not be excluded from taxable income, merely because realized from activities or business condemned by penal statutes. As for instance:

Taxing the income of a bootlegger from the illegal sale of liquor.

*United States v. Sullivan*, 274 U.S. 259.

Including in income "commissions" received from road construction company.

*Chadick v. United States*, 74 Fed. (2d) 961.

Gain from the purchase of sweepstake tickets.

*Christian H. Droge*, 35 B. T. A. 829.

Race track bookmaking.

*Jas. P. McKenna*, 1 B. T. A. 326.

Card playing.

*L. Weiner*, 10 B. T. A. 905.

Unlawful insurance policies.

*Patterson v. Anderson*, 20 F. Supp. 799.

Illegal prize fight pictures.

*George L. Rickard*, 15 B. T. A. 316.

In these cases actual gain can be computed, and the money is not recoverable from the taxpayer by those who paid him.

*We further concede that gains and profits received by a taxpayer and held by him under a claim of right not theretofore adversely adjudicated or denied by settled law, may be taxed to the recipient, although earned or received under such circumstances that third persons could have demanded an accounting from the taxpayer for all or a part thereof.*

Such cases are well known:

Secret profits realized by a director of a corporation from dealings in the property of the corporation.

*City National Bank of N. Y. v. Helvering*, 98 Fed. (2d) 93.

Profits openly earned by an officer of a corporation but at the expense of the corporation.

*Board v. Commissioner*, 51 Fed. (2d) 73.

Usurious interest actually collected.

*Barker v. Magruder*, 95 Fed. (2d) 122.

Income of an attorney from the settlement of claims for less than the amount advanced to him for such purpose by his client.

*United States v. Wampler*, 5 Fed. Supp. 796.

Excessive commissions or bonuses to corporate officers.

*Saunders v. Commissioner*, 101 Fed. (2d) 407.

Excessive tariff charges.

*Chicago, R. I. & P. Ry. v. Commissioner*, 47 Fed. (2d) 990.

Dividends on stocks prematurely distributed.

*Ford v. Commissioner*, 51 Fed. (2d) 206.

It must be remembered that in all the last cited cases there was a *business transaction* and a holding under a *claim of right*. Further, no adjudication of the duty to return had been made or denied by settled law.

It will be readily found, as said in the case of *Moore v. Thomas*, 131 Fed. (2d) 611, at page 613, that money obtained by embezzlement is a case of "special circumstances." In deciding against petitioners in that Court, the Tax Court rested its opinion "on the authority of *Estate of Thomas Spruance*, *Kurrle v. Helvering* and *Humphreys v. Commissioner*" (R. 20). The first case, *Estate of Thomas Spruance*, 43 B. T. A. 221, was actually the *McKnight* case, reversing *Spruance* on appeal (127 Fed. (2d) 572). The case of *Humphreys v. Commissioner* does not involve embezzlement, but, as we have hereinbefore illustrated in this brief, is a case of an illegal business transaction with a claim of right to ransom money by a kidnaper, upon delivery of the body of the victim. Thus, only one case, *Kurrle v. Helvering*, supra, involves embezzlement, and that case does not follow the theory of the law of embezzlement that there is an immediate obligation of the embezzler in law to repay which offsets any concept of income, gain or profit.

## V.

### **Local Law Must Determine Whether the Taking Was Without a Claim of Right From the Time of the First Appropriation.**

In its decision, the Circuit Court below (*Wilcox v. Commissioner*, 148 Fed. (2d) 933), applied the local law of the State of Nevada where the alleged embezzlement took

place to ascertain whether there was an immediate off-setting obligation. At page 934 of 148 Fed. (2d), the Court said (R. 32):

"[1] The crime of embezzlement in Nevada is complete when the embezzler "use[s] or appropriate[s] such money \* \* \* in any manner, or for any other purpose, than that for which the same was \* \* \* intrusted." State v. Trolson, 21 Nev. 419, 425, 427, 32 P. 936, 931. Here the record shows that the appropriation, for gambling purposes occurred at the taking of the moneys.

[2, 3] Under the law of Nevada the employer here could have replevined the embezzled moneys in the possession of the embezzler as soon as he appropriated them. See, 8681, Nevada Compiled Laws, 1929; Perkins v. Barnes, 3 Nev. 557; Studebaker Co. v. Witcher, 44 Nev. 568, 471, 199 P. 477, 201 P. 322. Also under the Nevada law an embezzler is liable to the party from whom the property is appropriated for an amount equal to its value. This is so whether after appropriation the moneys are hid in a basement or used in gambling. The use in no way transfers the property right of the owner in the moneys."

Nevada statutes further provide that embezzled property may be summarily restored to its owner by a magistrate. Nevada Compiled Laws, 1929, Sections 11243-11246. Hence, under local law, in view of the stipulation of facts (R. 9-13) that the funds were embezzled, no title to the funds could have passed to the embezzler, and it is apparent that (1) no claim of right did or could exist, and (2) the obligation of the embezzler set-off and counter-balanced any conception of gain, income or profit.

## VI. CONCLUSION

WHEREFORE, it is respectfully submitted that there is no conflict between the Circuit Courts of Appeal upon the question of whether embezzled money constitutes income to the embezzler. Furthermore, the test adopted by the Circuit Courts in applying *North American Oil v. Burnet*, supra, to determine whether there is a claim of right is a judicious and accurate legal analysis for definition of income, gain or profit under Section 22(a) of the Internal Revenue Code. There being no conflict between the Circuit Courts and the application by said Courts of the law being in accord with the Supreme Court's rule of decision, the petition for certiorari should be denied.

Respectfully submitted,

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Reno, Nevada.

Reno, Nevada, August 31, 1945.

No. 163

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**In the Supreme Court of the United States**

OCTOBER TERM, 1945

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

LAMED WILCOX AND MAUD WILCOX

---

**ON WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR  
THE NINTH CIRCUIT**

---

**BRIEF OF RESPONDENTS**

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No. 163

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COMMISSIONER OF INTERNAL REVENUE, PETITIONER

LAIRD WILCOX AND MAUD WILCOX

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ON WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR  
THE NINTH CIRCUIT

---

BRIEF OF RESPONDENTS

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ARGUMENT

This case involves the construction of Section 22(a) of the Internal Revenue Code which reads:

SEC. 22 GROSS INCOME.

(a) General Definition—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*

In the case below, *Wilcox v. Commissioner*, 148 Fed. (2d) 933, the Circuit Court of Appeals for the Ninth Circuit held that embezzled funds did not constitute taxable gain or profit or income under Section 22(a) *supra*. The decision followed that of Circuit Court of Appeals for the Fifth Circuit in *McKnight v. Commissioner*, 127 Fed. (2d) 572. Both Circuit Courts reversed the Tax Court to reach the result.\* In each case the Circuit Court had the benefit of the contra decision in *Kurrle v. Helvering*, 126 Fed. (2d) 723 (C. C. A. 8th) and rejected it.

Said the Circuit Court in *McKnight v. Commissioner*, (at page 574 of 127 Fed. (2d)):

"Our attention is called to the decision in *Kurrle v. Helvering*, 8th Cir. 126 Fed. (2d) 723, decided since this case was argued, where embezzled funds and the profits made by using them were taxed to the embezzler. We agree that the profits made by using embezzled funds are income and taxable as such, though possibly recoverable by the owner of the funds; *but we think no taxable gain arises by the embezzlement itself.*" (Italics supplied.)

Of the *Kurrle Case* the Court below said, (at page 935 of 148 Fed. (2d)):

"Respondent claims that the decision in the Eighth Circuit in *Kurrle v. Helvering*, 126 Fed. 2d 723, 725, is contra. That decision, however, relies upon the statement of law in the North American Consolidated Oil case, *supra*, concerning a taxpayer who "receives

\* *Wilcox v. Commissioner*, Tax Court Memo. Dock. 3743, C. C. H. Dec. 14, 107, Aug. 21, 1944, reversed in *Wilcox v. Commissioner*, 148 Fed. (2d) 933; *Spruance v. Commissioner*, 43 B. T. A. 221, reversed sub. nom. *McKnight v. Commissioner*, 127 Fed. (2d) 572.

earnings under a claim of right" and appears to hold that, though received without claim of right, they are taxable if the embezzler subsequently "treated said funds as his own" in a profitable enterprise. If this be not a ground of distinguishing the Kurre case from the instant review, we are not in accord with that opinion."

In construing Section 22(a) it is to be noted that income is defined as "... gains, profits and income derived from ... dealings in property ... growing out of the ownership or use of, or interest in such property; also ... gains or profits and income derived from any source whatever." This means there must be a *gain*, or a *profit*, or an *income*. The Commissioner argues that the *use* of the money by the embezzler justifies the tax, but the tax is not upon the use in itself—it is upon the gain, income or profit *derived from the use or growing out of the use*. It is agreed by all courts, and the litigants here, that gains or profits arising out of or from dealings or investment of the embezzled money would be taxable as income. However, the question before the Court is solely whether the embezzled monies are per se gains, profits or income.

The Commissioner argues that the embezzler having had the benefit of the embezzled funds, it should be regarded as the receipt of income by him. The respondent here who embezzled the money received no benefit as appears from the record showing loss of the money and subsequent imprisonment (R. 18). The dominion over and benefit of money may be equally argued, without success, as the basis for income tax upon gifts or loans.

The complete transfer to another of control over prop-

erty constitutes a gift and is taxable as such, but not as income. Mere benefit and enjoyment of property itself is the basis of a property tax.

Neither is borrowed money converted into income if the borrower spends the money for his own pleasure and exercises a dominion over it and obtains benefit from it. *William G. Stayton, Jr.*, 32 B. T. A. 940; *Carl G. Fisher*, 7 B. T. A. 968; *Shuster v. Helvering*, 121 Fed. (2d) 643.

Although "derived from any source whatever," be it out of a gift, a loan, or embezzled funds, income must be a gain or a profit. It cannot be the fund itself, but what the fund creates or produces.

The Circuit Court in the *McKnight case*, *supra*, treats the embezzler as a debtor, and states, (at page 573 of 127 Fed. (2d)):

"We find insuperable difficulties in the way of the conclusion that one who embezzles funds entrusted to him realizes gain and receives taxable income thereby. Gain is very broadly defined, as to its sources, in the Revenue Acts, Revenue Act 1934, Sect. 22; Revenue Act 1936, Sect. 22(a), 26 U. S. C. A. Int. Rev. Code, par. 22. The classic definition of income is: "Gain derived from capital, from labor, or from both combined," provided it be understood to include profit gained through a sale or conversion of capital assets." *Eisner v. Macomber*, 252 U. S. 189, 40 S. Ct. 189, 193, 64 L. Ed. 521, 9 A. L. R. 1570. It does not appear here what the embezzler did with what he took, whether he realized any profit from its use or conversion, or even got any enjoyment by spending it. All we know is it is gone and he is left insolvent. Was gain realized by the act of taking? We think not. He got no title, void or voidable, to what he took. He was still in possession as he was before, but with a

changed purpose. *He still had no right nor color of right. He claimed none. This the Board seems to concede, and finds that the gain arose on his using the funds for his own purposes, whatever they were. The time of using, and not the time of taking, then would determine the incidence of the tax, and about that nothing is known. But when the entrusted fund is used, or even when taken with the purpose of dishonest use, the law immediately and absolutely fixes upon the embezzler the duty to account for and to repay the value of what is taken. No action or election by the owner is necessary. By the taking the embezzler incurs an equivalent debt as surely as if he had borrowed with the consent of the owner. The first takings are, indeed, nearly always with the intention of repaying, a sort of unauthorized borrowing. It must be conceded that no gain is realized by borrowing, because of the offsetting obligation. This would be true even though at the time there was no intention to repay. It seems to us that the same thing is true of each act of embezzlement. Commissioner v. Turney, 5 Cir., 82 F. 2d 661.*" (Italics supplied.)

We have stipulated with the Commissioner that the embezzled money is still due the rightful owner and that the owner always has and now does hold the taxpayer liable to restore the same. (R. 12-13.)

Thus, there is in the instant case an established creditor-debtor relationship between the embezzler and the rightful owner. There being an unqualified duty and obligation to repay, the embezzler has no taxable gain or profit. And under the principle involved, there can be no difference whether the money was legally borrowed or illegally taken. In both cases, the duty to repay immediately impresses itself upon the funds, offsetting any concept of gain or profit.

It is the law of Nevada, where the alleged embezzlement took place, that the offense is complete when the appropriation is made. *State v. Trolson*, 21 Nev. 419, 425, 427; 32 Pac. 930, 931; *Wilcox v. Commissioner*, 148 Fed. (2d) 933, 934. Also under Nevada law the owner could have replevined the moneys in possession of the embezzler, as soon as he appropriated them. Sec. 8681, *Nevada Compiled Laws, 1929*; *Perkins v. Barnes*, 3 Nev. 557; *Studebaker Co. v. Witcher*, 44 Nev. 468, 471; 199 Pac. 477, 201 Pac. 322. Nevada statutes further provide that embezzled property may be summarily restored to its owner by a magistrate. Sections 11243-11246, *Nevada Compiled Laws, 1929*. Hence, under local law the obligation of the embezzler set off and counter-balanced any conception of gain, profit or income. There could be no ownership or claim of right by the embezzler and even though, as stated by the Commissioner, "as against all the world except the true owner the embezzler or thief is the legal owner," it is not *ownership* or the appropriation of money which forms the basis of taxable income, but gains or profit *derived from ownership or use*.

*Helvering v. Clifford*, 309 U. S. 331; *Burnet v. Wells*, 289 U. S. 670, and *Helvering v. Horst*, 311 U. S. 112, cited by the Commissioner to illustrate the application of the doctrine that tax liability rests upon the enjoyment of privileges and benefits and the exercise of ownership are not in point here at all. In those cases there was an income derived and growing out of a fund, either trust or bonds; which gave a gain or profit to the respondent in each case. Actual income in *Helvering v. Clifford*, *supra*, of a short-

term trust created by a husband for his wife was taxed to the husband who controlled it. There was no question of the *existence* of income, but only to whom it was taxable. In *Burnet v. Wells, supra*, actual income of a trust when used to maintain insurance on the life of the settlor, was taxable to him as income. In *Helvering v. Horst, supra*, coupons reflecting income detached from the bonds by a donor thereof were taxable to him as income as a fruit of his investment which he obtained and disposed of as any other gift of income might be disposed.

The Commissioner relies on *Kurrle v. Helvering, supra*. An examination of that case will reveal that there was a finding that the embezzler "treated said funds as his own." (See page 724 of 126 Fed. (2d). Thus, the *Kurrle Case* is not controlling here and is distinguishable from the instant case and the *McKnight Case, supra*, on that ground. All the facts are not stated in *Kurrle v. Helvering, supra*, but from what is there said it is evident that the petitioner was a banker who used the moneys of depositors for his own personal market operations, treating the money as his own while on deposit. In such a situation it is clear that the money was taxable when so taken as the banker must have made claim of right to it while on deposit, merely giving depositors credit, but taking title to the funds. In the instant case at bar and in the *McKnight Case* no claim of right is found—there is an outright conversion completely lacking in any possessory right.

Although the case of *North American Oil v. Burnet*, 286 U. S. 417, did not involve embezzlement, the principle of that case laid down at page 424 of 286 U. S. has been

rightfully used to determine what is income. The Court there said:

"If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

The foregoing language has been relied on by numerous Circuit Courts, asking in each case whether the funds were received or appropriated with a claim of right, in order to arrive at the solution of whether funds are income to the receiver or appropriator. The rule of the *North American Oil Case* was applied in *Commissioner v. Turney*, 82 Fed. (2d) 661 (C. C. A. 5th), holding that mere possession and holding of money by an officer of a state without a well-founded claim of right does not constitute taxable income to such official. It is interesting to note that in *Kurle v. Helvering*, 126 Fed. (2d) 723 (C. C. A. 8th), upon which the Commissioner relies, the Circuit Court of Appeals used the test of claim of right of the *North American Oil Case* in deciding the action. (See page 725 of 126 Fed. (2d).) Again the rule was applied in *Moore v. Thomas*, 131 Fed. (2d) 611 (C. C. A. 5th), the Court saying at page 613:

"Here, insisting that his proof showed that the moneys taken by the taxpayer and reported as income were not in fact such but were the results of misappropriation or embezzlement of its subscribers' funds, appellant urges that our decision in *McKnight v. Com'r*, 5 Cir., 127 F. 2d 572, requires a reversal. Appellee, insisting that the record does not show this but on the contrary shows that all of the moneys

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taken and reported as income were taken under a claim of right, urges that not *McKnight v. Comm.*, but *North American Oil Consolidated v. Barnett*, 286 U. S. 417, 52 S. Ct. 613, 76 L. Ed. 1197, *National City Bank of New York v. Helvering*, 2 Cir., 98 F. 2d 93, *Barker v. Magruder*, 68 App. D. C. 211, 95 F. 2d 122, *Chicago, R. I. & P. R. Co. v. Com'r*, 7 Cir., 47 F. 2d 990, *Board v. Com'r*, 6 Cir., 51 F. 2d 73, control the decision here. We agree with appellee. Appellant's reliance on *McKnight's* case will not at all do. That, as the carefully written opinion points out, was a case of special circumstances. It was not intended to be, it was not, in conflict with the rule announced in *North American Oil Co. v. Barnett* and correctly applied in *National City v. Helvering*. *What was absent in McKnight's case, an appropriation under a claim of right, was present in those two cases and is present here.* The fact of which appellant seeks to make so much, that its officers, in asserting taxpayer's claim to the attorney-in-fact fees, acted with the corrupt motive of securing their distribution to themselves, is without bearing. The income of these officers and their title to the disbursed funds is not in question." (Italics supplied.)

In *Caldwell v. Commissioner*, 135 Fed. (2d) 488 (C. C. A. 5th), the yardstick of the *North American Oil Case* was applied. The Court said at page 491:

"These 'kickbacks' do not at all appear to be plain embezzlements of the State's funds, but were paid by the contractors as their money, and *received by Caldwell as his own*. It may be that they were in some cases a fraud on the State for which it may recover, and Caldwell may be entitled in the year of such payment to a deduction, but until then they are his income. The situation is controlled by *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 52 S. Ct. 613, 76 L. ed. 1197, rather than *McKnight v. Commissioner*, 5 Cir., 127 F. 2d 572." (Italics supplied.)

In *National City Bank of New York v. Helvering*, 98 F. (2d) 93, cited by the Commissioner, there was a *finding* by the Board of Tax Appeals (now the Tax Court) that the taxpayer "took all the bonds as his own" (page 95 of 98 Fed. (2d)). The Court then stated (at page 96):

"If he [the taxpayer] holds with *claim of right*, he should be *taxable* as an owner, regardless of any infirmity of title. (Italics supplied.)"

The remarks in that case regarding embezzled funds were unnecessary to the decision in the light of the findings that no embezzlement existed and should be disregarded as dicta.

Money taken through embezzlement is not taxable gain and is distinguished from all other illegal acquisition which arises from unlawful business transactions.

*We concede that illegal profits and illegal gains are income.* It is well settled that actual gains or profits may not be excluded from taxable income, merely because realized from activities or business condemned by penal statutes. As for instance:

Taxing the income of a bootlegger from the illegal sale of liquor.

*United States v. Sullivan*, 274 U. S. 259.

Including in income "commissions" received from road constructions company.

*Chadick v. United States*, 77 Fed. (2d) 961.

Gain from the purchase of sweepstakes tickets.

*Christian H. Droge*, 35 B. T. A. 829.

Race track bookmaking.

*Jas. P. McKenna*, 1 B. T. A. 326.

Card playing.

*L. Weiner*, 10 B. T. A. 905.

Unlawful insurance policies.

*Patterson v. Anderson*, 20 F. Supp. 799.

Illegal prize fight pictures.

*George L. Rickard*, 15 B. T. A. 316.

In these cases actual gain can be computed, and the money is not recoverable from the taxpayer by those who paid him.

*We further concede that gains and profits received by a taxpayer and held by him under a claim of right not theretofore adversely adjudicated or denied by settled law, may be taxed to the recipient, although earned or received under such circumstances that third persons could have demanded an accounting from the taxpayer for all or a part thereof.*

Such cases are well known:

Secret profits realized by a director of a corporation from dealings in the property of the corporation.

*National City Bank of N. Y. v. Helvering*, 98 Fed. (2d) 93.

Profits openly earned by an officer of a corporation but at the expense of the corporation.

*Board v. Commissioner*, 51 Fed. (2d) 73.

Usurious interest actually collected.

*Barker v. Magruder*, 95 Fed. (2d) 122.

Income of an attorney from the settlement of claims for less than the amount advanced to him for such purpose by his client.

*United States v. Wampler*, 5 Fed. Supp. 796.

Excessive commissions or bonuses to corporate officers.

*Saunders v. Commissioner*, 101 Fed. (2d) 407.

Excessive tariff charges.

*Chicago, R. I. & P. Ry. v. Commissioner*, 47 Fed. (2d) 999.

Dividends on stocks prematurely distributed.

*Ford v. Commissioner*, 51 Fed. (2d) 206.

It must be remembered that in all the last cited cases there was a *business transaction* and a holding under a *claim of right*. Further, no adjudication of the duty to return had been made or denied by settled law.

In *Humphreys v. Commissioner*, 125 Fed. (2d) 340 (C. C. A. 7th), Cert. den., 317 U. S. 637, cited by the Commissioner, there was an illegal business transaction with a claim of right to ransom money by a kidnapper, upon delivery of the body of the victim; and see also *Wilcox v. Commissioner*, 148 Fed. (2d) 933, 935. In *United States v. Wampler*, 5 Fed. Supp. 796, an attorney was taxable on income constituting money given to him to settle a case, part of which he retained after settling the matters for less than the amount delivered to him. The Court held that the act was not embezzlement (See page 798 of 5 Fed. Supp.). The money having been delivered in a business transaction for services there was a gain and profit.

The Commissioner argues that embezzled money should be taxable as income to the embezzler because the theft "creates a deductible loss from the beginning" to the

owner.\* Such argument should no more succeed herein than in the case of a borrower who takes a loan and is not liable for the same as income, while the lender, unable to recover the loan, may deduct the non-payment as a loss. (See Treasury Regulations 103, Sec. 19.23(k)-1; 26 U. S. C. 23(k)(1) ).

Comparison of the treatment of deductions for losses and thefts under the income tax law cannot determine what is income. Deductions, like exemptions, are privileges and will be allowed only when granted in clear language, the burden being on the taxpayer to show that he is within the statute granting the privilege of the deduction. *1 Mertens, Law of Federal Income Taxation*, 69, para. 3.08 (1942); *White v. U. S.*, 305 U. S. 281, 292.

On the other hand, taxable income must come within the import of Section 22(a), *supra*, of the Internal Revenue Code, and if doubt exists as to whether embezzled funds are taxable income, such doubt should be construed most strongly against the government and in favor of the taxpayer. *Gould v. Gould*, 245 U. S. 151, 153. It is for the government to find a gain or profit from embezzled funds within Section 22(a), *supra*. Only the *Kurrle Case*, *supra*,

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\*The reasoning in *Boston Consolidated Gas Co. v. Commissioner*, 128 Fed. (2d) 473 (C. C. A. 1st) sustains the position of respondents here that the owner from whom the money is embezzled does not sustain a loss at the time of the taking because of the offsetting obligation of the embezzler to repay. (See Concurring Opinion of Judge Magruder at page 477 of 128 Fed. (2d) ); See also *Glenn v. Louisville Trust Co.*, 124 Fed. (2d) 418, 420.

so held and that by giving the omnibus clause of the section a strained construction. True, income is "... gains or profits and income derived from any source whatever . . .", but the requirement of gain or profit is still present.

## CONCLUSION

A careful reading of Section 22(a) of the Internal Revenue Code will reveal that embezzled funds do not fall within its terms as taxable income. The exercise of use or ownership over funds does not convert such funds into taxable gain, profit or income unless there is created or produced from such fund an actual gain or profit. The complete lack of a claim of right to the funds, conceded by the Commissioner, emphasizes the rule of numerous cases that the funds can not constitute income. Furthermore, the unqualified obligation of the embezzler to restore the funds to the owner, as stipulated by the Commissioner and respondents, completely counter-balances any concept of gain, profit or income.

It is respectfully submitted that the judgment of the Ninth Circuit Court of Appeals should be affirmed.

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Reno, Nevada, December, 1945.

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# SUPREME COURT OF THE UNITED STATES.

No. 163.—OCTOBER TERM, 1945.

Commissioner of Internal Revenue,	} On Writ of Certiorari to	
Petitioner,		the United States Circuit
vs.		Court of Appeals for the
Laird Wilcox and Maud Wilcox.	} Ninth Circuit.	

[February 25, 1946.]

Mr. Justice MURPHY delivered the opinion of the Court.

The sole issue here is whether embezzled money constitutes taxable income to the embezzler under Section 22(a) of the Internal Revenue Code.<sup>1</sup>

The facts are stipulated. The taxpayer was employed as a bookkeeper by a transfer and warehouse company in Reno, Nevada, from 1937 to 1942. He was paid his salary promptly each month when due, it not being the custom to allow him to draw his salary in advance. In June, 1942, the company's books were audited and it was discovered for the first time that the taxpayer had converted \$12,748.60 to his own use during 1941.<sup>2</sup> This amount was composed of miscellaneous sums of money belonging to the company which he had received and collected at various times in his capacity as bookkeeper. He failed to deposit this money to the credit of the company. Instead he pocketed and withdrew payments in cash made to him by customers, neglecting to credit the customers' accounts or the company's accounts receivable with the funds received.

The taxpayer lost practically all of this money in various gambling houses in Reno. The company never condoned or forgave the taking of the money and still holds him liable to restore it. The taxpayer was convicted in a Nevada state court in 1942 of the crime of embezzlement. He was sentenced to serve from 2 to 14 years in prison and was paroled in December, 1943.

The Commissioner determined that the taxpayer was required to report the \$12,748.60 embezzled in 1941 as income received in

<sup>1</sup> 26 U. S. C. § 22(a).

<sup>2</sup> The sum of \$10,147.41 was embezzled during 1942 but that amount is not in issue in this case.

2. *Commissioner of Internal Revenue vs. Wilcox.*

that year and asserted a tax deficiency of \$2,978.09. The Tax Court sustained the Commissioner but the court below reversed. 148 F. 2d 933. We granted certiorari because of a conflict among circuits as to the taxability of embezzled money.<sup>3</sup>

Section 22(a) of the Internal Revenue Code defines "gross income" to include "gains, profits and income derived from . . . dealings in property . . . growing out of the ownership or use of or interest in such property; also . . . from the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever." The question thus is whether the wrongful acquisition of funds by an embezzler should be included in the statutory phrase "gains or profits and income derived from any source whatever," thereby constituting taxable income to the embezzler.

The Commissioner relies upon the established principle that orthodox concepts of ownership fail to reflect the outer boundaries of taxation. As this Court has stated, tax liability "may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." *Burnet v. Wells*, 289 U. S. 670, 678. See *Helvering v. Clifford*, 309 U. S. 331; *Helvering v. Horst*, 311 U. S. 112. Applying that rule to this case, the Commissioner urges that the act of appropriating the property of another to one's own use is an exercise of a major power of ownership even though the act is consciously and entirely wrongful. As against all the world except the true owner the embezzler is the legal owner, at least while he remains in possession. The money or property acquired in this unlawful manner, it is said, should therefore be treated as taxable income to the wrongdoer under Section 22(a). We cannot agree.

Section 22(a) is cast in broad, sweeping terms. It "indicates the purpose of Congress to use the full measure of its taxing power within those definable categories." *Helvering v. Clifford*, *supra*, 334. The very essence of taxable income, as that concept is used in Section 22(a), is the accrual of some gain, profit or benefit to the taxpayer. This requirement of gain, of course, must be read in its statutory context. Not every benefit received by a

<sup>3</sup> The decision below is in accord with *McKnight v. Commissioner*, 127 F. 2d 572 (C. C. A. 5), but is in conflict with *Kurrie v. Helvering*, 126 F. 2d 723 (C. C. A. 8). See also *Boston Consol. Gas Co. v. Commissioner*, 128 F. 2d 473, 476-477 (C. C. A. 1, concurring opinion).

taxpayer from his labor or investment necessarily renders him taxable. Nor is mere dominion over money or property decisive in all cases. In fact, no single, conclusive criterion has yet been found to determine in all situations what is a sufficient gain to support the imposition of an income tax. No more can be said in general than that all relevant facts and circumstances must be considered. See Magill, *Taxable Income* (1945).

For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Section 22(a). See *North American Oil v. Burnet*, 286 U. S. 417, 424. Nor can taxable income accrue from the mere receipt of property or money which one is obliged to return or repay to the rightful owner, as in the case of a loan or credit. Taxable income may arise, to be sure, from the use or in connection with the use of such property. Thus if the taxpayer uses the property himself so as to secure a gain or profit therefrom, he may be taxable to that extent. And if the unconditional indebtedness is cancelled or retired taxable income may adhere, under certain circumstances, to the taxpayer. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of Section 22(a).

We fail to perceive any reason for applying different principles to a situation where one embezzles or steals money from another. Moral turpitude is not a touchstone of taxability. The question, rather, is whether the taxpayer in fact received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of Section 22(a).

It is obvious that the taxpayer in this instance, in embezzling the \$12,748.60, received the money without any semblance of a bona fide claim of right. And he was at all times under an unqualified duty and obligation to repay the money to his employer. Under Nevada law the crime of embezzlement was complete whenever an appropriation was made;<sup>4</sup> the employer was entitled to

<sup>4</sup>State v. Trolson, 21 Nev. 419, 32 P. 930.

replevy the money as soon as it was appropriated<sup>5</sup> or to have it summarily restored by a magistrate.<sup>6</sup> The employer, moreover, at all times held the taxpayer liable to return the full amount. The debtor-creditor relationship was definite and unconditional. All right, title and interest in the money rested with the employer. The taxpayer thus received no taxable income from the embezzlement.

This conclusion is unaltered by the fact that the taxpayer subsequently dissipated all of the embezzled funds in gambling houses. The loss or dissipation of money cannot create taxable income here any more than the insolvency or bankruptcy of an ordinary borrower causes the loans to be treated as taxable income to the borrower. See *McKnight v. Commissioner*, 127 F. 2d 572, 573-574. In each instance the taxability is determined from the circumstances surrounding the receipt and holding of the money rather than by the disastrous use to which it is put. Likewise, the fact that a theft or loan may give rise to a deductible loss to the owner of the money does not create income to the embezzler or the borrower. Such deductions, lacking any necessarily corresponding relationship to gains and being a matter of legislative grace, fail to demonstrate the existence of taxable income.

Had the taxpayer used the embezzled money and obtained profits therefrom such profits might have been taxable regardless of the illegality involved.<sup>7</sup> Or had his employer condoned or forgiven any part of the unlawful appropriation the taxpayer might have been subject to tax liability to that extent. But neither situation is present in this proceeding and we need not explore such possibilities. Sanctioning a tax under the circumstances before us would serve only to give the United States an unjustified preference as to part of the money which rightfully and completely belongs to the taxpayer's employer.

The Tax Court's determination that the embezzled money constituted taxable income to the embezzler, a result in accord with

<sup>5</sup> Nevada Compiled Laws (1929) § 8681; *Perkins v. Barnes*, 3 Nev. 557; *Studebaker Co. v. Witcher*, 44 Nev. 468, 199 P. 477.

<sup>6</sup> Nevada Compiled Laws (1929) §§ 11243-11246.

<sup>7</sup> See *Johnson v. United States*, 318 U. S. 489; *United States v. Sullivan*, 274 U. S. 259; *Caldwell v. Commissioner*, 135 F. 2d 488; *Chadick v. United States*, 77 F. 2d 961; *National City Bank v. Helvering*, 98 F. 2d 93. See also *Mann v. Nash* [1932] 1 K. B. 752; *Southern v. A. B.* [1933] 1 K. B. 713.

its prior decisions on the issue,<sup>8</sup> involved a clear-cut mistake of law. The court below was therefore justified in reversing that judgment. Cf. *Commissioner v. Scottish American Co.*, 323 U. S. 119; *Dobson v. Commissioner*, 320 U. S. 489; *Trust of Bingham v. Commissioner*, 325 U. S. 365.

*Affirmed.*

Mr. Justice JACKSON took no part in the consideration or decision of this case.

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<sup>8</sup> See *Spruance v. Commissioner*, 43 B. T. A. 221, reversed *sub nom.* *McKnight v. Commissioner*, 127 F. 2d 572; *Kurrie v. Commissioner*, Prentice-Hall 1941 B. T. A. Memorandum Decisions, par. 41,985, affirmed 126 F. 2d 723. The administrative interpretation is to the same effect as the Tax Court's decisions. G. C. M. 16572, XV-1 Cum. Bull. 82 (1936).

# SUPREME COURT OF THE UNITED STATES.

No. 163.—OCTOBER TERM, 1945.

Commissioner of Internal Revenue,	} On Writ of Certiorari to	
Petitioner,		the United States Circuit
vs.		Court of Appeals for the
Laird Wilcox and Maud Wilcox.	} Ninth Circuit.	

[February 25, 1946.]

Mr. Justice BURTON, dissenting.

By holding in this case that embezzled funds do not constitute a taxable gain to the embezzler under the Internal Revenue Code, I believe the Court misinterprets the Code. That interpretation is contrary to the established administrative construction of the Code and to what appears to be the intent of § 22(a) as disclosed by its legislative history. Section 22(a) expressly includes in the net income of a taxable person gains or profits and income derived from any source whatever." 26 U. S. C., § 22(a). It is difficult to imagine a broader definition. This Court has said of this section, "The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories." *Helvering v. Clifford*, 309 U. S. 331, 334.

The legislative history of the section demonstrates the Congressional intent to tax not merely "lawful" gains but all gains lawful or unlawful. Section 11 B of the Income Tax Act of 1913, 38 Stat., provided originally that—

"... the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ." (Italics supplied.)

The Revenue Act of 1916 (39 Stat. 757), § 2(a), reenacted this provision omitting only the word "lawful" before the word "business" so that now the final clause, as incorporated in § 22(a), reads, "also from interest, rent, dividends, securities, or the transaction of *any business* carried on for *gain or profit, or gains or profits and income derived from any source whatever.*" (Italics supplied.) The 1916 amendment demonstrated an intent to include gains, profits and income from any unlawful business as well as from any lawful business. It is inescapable evidence of a like intent to include unlawful as well as lawful "gains . . . from any source whatever." See *United States v. Sullivan*, 274 U. S. 259.

There have been many decisions to the effect that this section includes such unlawful gains as those from illicit traffic in liquor,<sup>1</sup> race-track bookmaking,<sup>2</sup> card playing,<sup>3</sup> unlawful insurance policies,<sup>4</sup> illegal prize fighting pictures,<sup>5</sup> lotteries,<sup>6</sup> graft,<sup>7</sup> fraudulent misapplied moneys of a client by an attorney,<sup>8</sup> "protection payments" to racketeers and ransom money paid to a kidnapper.<sup>9</sup>

The majority opinion in the present case recognizes that had "the taxpayer used the embezzled money and obtained profits therefrom such profits might have been taxable regardless of the illegality involved." The majority opinion therefore does not exempt the embezzled funds from taxation merely because there is "illegality involved". The opinion reaches its result by reading into § 22(a) a legislative distinction I do not find there. The opinion limits the section to such gains, unlawful or not, as are accompanied with "a claim of right" by the taxpayer and as are not accompanied with "a definite unconditional obligation to repay or return that which would otherwise constitute a gain."

<sup>1</sup> *United States v. Sullivan*, 274 U. S. 259. See also, *Steinberg v. United States*, 14 F. 2d 564; *Maddas v. Commissioner*, 40 B. T. A. 572, affirmed, 114 F. 2d 548; *Poznak v. Commissioner*, 14 B. T. A. 727.

<sup>2</sup> *M'Kenna v. Commissioner*, 1 B. T. A. 326.

<sup>3</sup> *Weiner v. Commissioner*, 16 B. T. A. 905.

<sup>4</sup> *Patterson v. Anderson*, 20 F. Supp. 799.

<sup>5</sup> *Rickard v. Commissioner*, 15 B. T. A. 316.

<sup>6</sup> *Droge v. Commissioner*, 35 B. T. A. 829; *Huntington v. Commissioner*, 35 B. T. A. 835; *Voyer v. Commissioner*, 4 B. T. A. 1192.

<sup>7</sup> *Chadick v. United States*, 77 F. 2d 961, cert. denied, 296 U. S. 609.

<sup>8</sup> *United States v. Wampler*, 5 F. Supp. 796.

<sup>9</sup> *Humphreys v. Commissioner*, 42 B. T. A. 857, affirmed, 125 F. 2d 349.

Believing, as I do, that Congress in this section has sought "to use the full measure of its taxing power," and in doing so has sought to tax all "gains . . . from any source whatever," I am unable to recognize an adequate basis for reading into the broad sweep of the language the unexpressed limitation proposed in the majority opinion.

The embezzler's complete possession of the embezzled funds, his exercise of dominion over them to the extent of disposing of every cent of them and his transfer of possession of them to others in such a manner as to give the recipients title to them, amounts to such an ample enjoyment of them, use of them, dominion over them, disposition of them and receipt of benefits from them as to make them of obvious economic value to the embezzler. Such a readily realizable value presents no reasonable basis for exempting these funds from taxation that would be applied to them if earned in a lawful manner. The "Government . . . may tax not only ownership, but any right or privilege that is a constituent of ownership. . . . Liability may rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." *Burnet v. Wells*, 289 U. S. 670, 678.

In *National City Bank of New York v. Helvering*, 98 F. 2d 93, 96, L. Hand, J., writing for the court, said:

"Although taxes are public duties attached to the ownership of property, the state should be able to exact their performance without being compelled to take sides in private controversies. Possession is in general prima facie evidence of ownership, and is perhaps indeed the source of the concept itself, though the time is long past when it was synonymous with it. It would be intolerable that the tax must be assessed against both the putative tortfeasor and the claimant; collection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant."

In the present case, the embezzler concealed the embezzlement long enough to enable him to gamble away all of the embezzled funds. He asserted, falsely to be sure, but nonetheless positively, his right to dispose of the funds and he did dispose of them beyond all chance of their recovery. This was a use of them by him for his own enjoyment just as fully as though he had legal title to them. If he had made gambling or other profits from them he

would have claimed those profits as his own and would have been taxed on those profits. If he had gained possession of the original funds by extortion, fraud or usurious practices, those gains would be taxable to him under the general language of § 22(a). The majority opinion, however, holds that if he gained possession of the original funds by embezzlement then such gains are not to be taxed to him under that language. This reads into the section a sharp distinction between the embezzler and defrauder, exempting the former but not the latter. In the absence of an express declaration of such an intent by Congress I believe that the courts are not justified in reading such a distinction into this section.

Furthermore, where an embezzler uses embezzled funds for his own purposes and, by concealment of the embezzlement or otherwise, deprives his victim of a corresponding opportunity to enjoy those funds, the Code permits this victim to deduct as a "loss", from the victim's taxable income, the sums so embezzled.<sup>10</sup> See *Burnet v. Huff*, 288 U. S. 156. The allowance of such a deduction suggests the intent of Congress to transfer the liability for the tax on those funds to the embezzler. The majority opinion prevents such a transfer.

A point has been made of the fact that the Government's tax lien upon property of the embezzler would have priority over the claim of the victim of the embezzlement to recover from such property the losses which the victim suffered by the embezzlement. This priority of the tax lien is hardly an adequate argument to eliminate the tax itself. At most it is an argument for Congress to modify the tax lien in favor of the victim.

There is nothing in the Code that expressly requires, as a condition of the existence of a taxable gain, that there also be an absence of "a definite unconditional obligation to repay or return that which would otherwise constitute a gain." In the case of *National City Bank of New York v. Helvering*, *supra*, p. 95, the taxpayer was taxed on bonds which he had unlawfully withheld from the corporation of which he was an officer. These bonds were the property of the corporation in the sense that it could have reclaimed them and the court said—

"But there are several cases in which persons have been taxed upon property which could be recovered from them. For example, the lender upon usurious interest—if on an accrual

<sup>10</sup> 26 U. S. C. § 23(e).

basis must include his apparent profit in his return, though possibly he may be allowed to deduct it as a loss if the borrower recclaims it. *Barker v. Magruder*, 68 App. D. C. 211, 16 F. 2d 122. Again, when a railroad collects too large fares, the excess is income, though the passengers have a theoretical right of restitution. *Chicago R. I. & P. R. Co. v. Commissioner*, 7 Cir., 47 F. 2d 990.

The administrative interpretation of § 22 a) long has been to tax the embezzled funds. It dates at least from G. C. M. 16572, XVI, Cum. Bull. (1936) 82, in which it was expressly recommended that the "profits of an embezzler constitute taxable income in the hands of the embezzler for federal income tax purposes." This interpretation was followed by the Tax Court in this case and it has been regularly followed by the Board of Tax Appeals in the past. *Karrh v. Commissioner*, 1941 Prentice-Hall B. T. A. Mem. Decisions, ¶ 41,085, affirmed, 126 F. 2d 723; *Estate of Suranney v. Commissioner*, 43 B. T. A. 221, reversed *sub nom. McKnight v. Commissioner*, 127 F. 2d 572.

Because of the legislative history of § 22 a), the breadth of the language used by Congress in that section, the attempt of Congress to use the full measure of its taxing power in that section, the long established administrative practice of holding embezzled funds to be taxable income of the embezzler, and finally because of the arbitrary distinctions in favor of the embezzler which arise from an opposite interpretation of the Code, I believe that embezzled funds are taxable gains as defined by Congress.